S. Hrg. 101-974

HEARING ON THE SEMIANNUAL REPORT OF THE RESOLUTION TRUST CORPORATION—1990

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

SECOND SESSION

ON

THE FINANCIAL INSTITUTIONS REFORM, RECOVERY, AND ENFORCEMENT ACT OF 1989 [FIRREA] REQUIRES THAT THE OVERSIGHT BOARD TESTIFY TWICE A YEAR ON THE FOLLOWING SEVEN ISSUES:

NO. 1, PROGRESS MADE IN RESOLVING FAILED THRIFTS. NO. 2, THE ESTIMATED COST TO THE U.S. GOVERNMENT OF OBLIGATIONS ISSUED OR INCURRED BY THE RTC. NO. 3, PROGRESS IN SELLING ASSETS OF FAILED THRIFTS UNDER RTC CONTROL. NO. 4, THE ADMINISTRATIVE COSTS INCURRED BY THE RTC. NO. 5, THE RTC'S ESTIMATED INCOME FROM ASSET SALES. NO. 6, POTENTIAL SOURCES OF ADDITIONAL FUNDS FOR THE RTC, AND NO. 7, THE ESTIMATED REMAINING EXPOSURE OF THE U.S. GOVERNMENT IN CONNECTION WITH FAILED THRIFTS WHICH THE OVERSIGHT BOARD BELIEVES WILL REQUIRE ASSISTANCE OR LIQUIDATION IN THE FUTURE

MAY 23, 1990

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

U.S. GOVERNMENT PRINTING OFFICE
33-551 WASHINGTON : 1990

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

S241-8

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HEARING ON THE SEMIANNUAL REPORT OF THE RESOLUTION TRUST CORPORATION—1990

WEDNESDAY, MAY 23, 1990

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The committee met, pursuant to notice, at 10 a.m., in room SD-538 of the Dirksen Senate Office Building, Senator Donald W. Riegle, Jr. (chairman of the committee) presiding.

Present: Senators Riegle, Garn, Cranston, Dixon, D'Amato, Gramm, Heinz, Sarbanes, Sasser, Sanford, Shelby, Wirth, Kerry, Bond, Mack, Roth, and Kassebaum.

OPENING STATEMENT OF CHAIRMAN RIEGLE

The CHAIRMAN. As our witnesses get situated, let me welcome all in the room this morning, and particularly the very distinguished panel of people who are here to testify this morning.

I want to indicate at the outset that we have a vote that is scheduled this morning at 10:35. That vote time has moved at least twice, and it is always possible it might move again. But at the point at which the vote comes, it would be my intention to adjourn on an orderly basis, try to have as short an interruption as possible, and hopefully to be able to resume in about 10 or 12 minutes. So everybody is on notice that we will try to keep that time interruption to a minimum.

Today's hearing, I think, is one of the most important hearings that will take place this year in the Congress, and certainly the witnesses present attest to that.

This is the semiannual hearing with the Oversight Board on the Resolution Trust Corporation. The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 [FIRREA], requires that the Oversight Board testify twice a year on the following seven issues:

No. 1, progress made in resolving failed thrifts; No. 2, the estimated cost to the U.S. Government of obligations issued or incurred by the RTC; No. 3, progress in selling assets of failed thrifts under RTC control; No. 4, the administrative costs incurred by the RTC; No. 5, the RTC's estimated income from asset sales; No. 6, potential sources of additional funds for the RTC; and, No. 7, the estimated remaining exposure of the U.S. Government in connection with failed thrifts which the Oversight Board believes will require assistance or liquidation in the future. Clearly, the Congress, the administration, and the American people, are all deeply interested in these questions.

By way of looking at the road we have been over last year, the President to his credit, and his administration, tackled this problem head-on. The administration presented a package and asked for our help in enacting a tough reform bill. They asked us to treat that as our top priority. We did. We worked together on a bi-partisan basis, and we enacted the bill in record time. But just as the S&L problem built up over a decade, the 1980's, the thrift problem did not end with last year's legislation being enacted.

Today, it affects the budget of the Federal Government. It affects interest rates in the general economy, and it affects property values all across the country, and particularly in the regions where the problems were most severe.

Today's hearing gives the Oversight Board a chance to explain what is taking place at the RTC, and there are several issues of particular concern to members of the committee. No. 1, of course, and I lead with this, what the revised cost estimate is for finally resolving this problem in its entirety. No. 2, what the plans are for selling the real estate assets that have been taken back from failed thrifts, in light of the softness of the real estate market in various areas of the country. No. 3, what the pace is of thrift resolutions. Is the RTC's current accelerated resolution program reasonable? Under this program the RTC is attempting to sell 140 thrifts before the end of June. We need to know whether that is on track and what kind of deals are anticipated in that program.

There are many other questions, and I want to now go to my colleagues for their opening comments. Senator Garn?

OPENING STATEMENT OF SENATOR GARN

Senator Garn. Thank you very much, Mr. Chairman. Today, the Banking Committee continues its oversight duties regarding the resolution of the savings and loan crisis. Perhaps the crisis atmosphere has diminished somewhat, and that is probably all to the good if it calms the fears of the depositors whose funds are not now, and never were at risk.

The level of concern on the part of this Senator, shared by my colleagues I am sure, continues at an extremely high level. As long as the job remains to be done, the taxpayers funds are at risk. All who have testified before the committee have emphasized the need for a quick resolution, perhaps haste makes waste, but delay is likely to cost us even much more. Still many criticisms are heard that this recognition has not yet fully been matched by results. We have heard and we understand the arguments about delays associated with start-up of such a major undertaking.

Cost of the bail out keeps getting bigger as we knew it could. The administration acknowledged during the FIRREA debate that cost assumptions were sensitive to interest rates and the health of the real estate markets and could go higher. Unfortunately, interest rates have not declined and the real estate markets, in fact, have gotten worse in many areas.

Like it or not, the institutions of RTC is trying to salvage are real estate lenders. Their assets are deteriorating with the market and institutions which might acquire thrifts or their assets are shying away because they are under pressure to improve their portfolios and capital ratios. For these reasons, the value of thrift assets is declining and the RTC is being forced to hold more of them for longer periods.

It is hard to say how much this will drive up the cost or how long it will continue to cause the problem. From what the administration is telling us today the price will be much higher than the $73 billion estimate early last year. The bottom line is whatever the cost, RTC must do its job and the taxpayers will bear the cost. The quicker the funding authorities provide it and the job is done, the lower the ultimate cost will be.

If I might make an analogy, we entered World War II without adequate preparation. Starting up our war effort was a major undertaking, probably the greatest any Nation has ever faced. We started from almost nothing with little preparation. Our losses at first were enormous, and delay could only make them worse. We did not hesitate in getting on with the job. Less than 4 years after we entered that war it was over, and our enemies were completely defeated. As the Oversight Board, I might suggest that you represent the Joint Chiefs of Staff in this struggle. You lay out the overall strategy, you also have a responsibility to see that the strategy is implemented, and you owe it to the taxpayers, as we do, that it be implemented as quickly and effectively as possible.

I guess the question I have is, will the enemy be defeated in this enormous assault and financial health of the country be restored within the 7 year life of the RTC? To continue my analogy, there are some important parallels and lessons to be learned. When we entered World War II we were united. Everyone realized that it would be irresponsible to indulge in partisanship in a national emergency.

This S&L crisis is far too serious and far too great to play partisan politics. Pointing fingers and trying to pass off blame for the cost. There certainly is plenty of blame and plenty of cost to go around for everyone—the administration and Congress as well. The need here is to lay politics aside and get on with our job. We must provide adequate resources quickly, and the job of the administration is to use these resources quickly and effectively.

I guess we need a Midway or El Alamain, and certainly no more Corregidors. That is the report that we look forward to at your next appearance before this committee. I certainly believe that the signs are already there that progress is being made. The RTC is reportedly in the midst of a flurry of resolution activity. It is at the first stage of implementing a vigorous asset sales program. Other preliminary measures now seem to have been completed.

During World War II, after the time of unrelenting losses seemed at last to have peaked, Churchill reported to his Nation that they had not witnessed the end, not even the beginning of the end. He said perhaps it was the end of the beginning. I certainly hope, at least at this point, after several years of unnecessary delay, that we are at least at that point in the process where we are at the end of the beginning of the savings and loan crisis, and we can see a lot more action over the next few months.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Garn. We will follow the practice this morning of calling on other Senators for brief opening comments. Next is Senator Cranston.

Senator CRANSTON. I am delighted the Board is with us. We need to hear from them, so I will restrain myself and make no opening statement.

The CHAIRMAN. Senator Heinz?

Senator HEINZ. Mr. Chairman, I ask unanimous consent that my entire statement appear in the record.

The CHAIRMAN. Without objection.

STATEMENT OF SENATOR JOHN HEINZ

Senator HEINZ. Mr. Chairman, I join you in welcoming the members of the Oversight Board of the Resolution Trust Corporation. It has been 10 months since this Board was entrusted with the task of cleaning up the largest financial disaster in modern history. Ten months is enough time to assess whether the RTC has hit the ground running or is running into the ground.

I have never attempted to understate the enormity of task, but I must admit that I find it difficult to appreciate the enormity of the cost. Today, the Oversight Board will present the latest—but probably not the last—estimate of the cost of the savings and loan crisis. What we thought was a $50 billion hole has turned out to be more like a crater—and is rapidly looking like a bottomless pit. Whoever surveyed the size of the problem in the S&L industry 10 months ago must have been looking through the wrong end of the telescope.

Hopefully, we now have a clearer image of the extent of the problems that we must confront. It is not a pretty picture. The number of failed thrifts in the RTC has grown from 262 to 423 and hundreds more are on the way. Unwanted assets are piling up at a phenomenal rate. Soft real estate markets are creating a hard reality. There is a real risk that a Government fire sale can cause the whole economy to go up in smoke. But if we don't clean up the S&L mess, it is the taxpayers who will be taking a bath.

It is also disturbing that in the midst of this multi-billion dollar problem we cannot find the relatively few millions of dollars to prosecute those who treated federally insured savings and loans like their personal piggy bank. Only two-thirds of the $75 million authorized by Congress for the Justice Department has been appropriated. Senator Wirth and I both tried during the Supplemental Appropriations bill to find the funds needed to fill this hole. Unfortunately, programs that spend taxpayer dollars were more popular than a program designed to get taxpayer dollars back.

Mr. Chairman, at our last oversight hearing I asked the Oversight Board whether they had the tools needed to do their job. I was concerned that the S&L bill may have reduced the value of the thrifts that the RTC had to sell. I will be interested to learn whether they are ready to ask Congress for a longer legislative ladder to help them climb out of what they now realize is a much deeper hole.

Mr. Chairman, I want to welcome our Oversight Board back. It seems like we had them here only yesterday, and I guess they feel they were here yesterday. We are here to find out whether they have hit the ground running, or simply run into the ground.

I don't think we have ever attempted to minimize the enormity of the task they face. We all find it difficult to appreciate the enormity of the cost. Today, we expect the Oversight Board will present the latest and, frankly, I doubt it will be the last estimate of the cost of this crisis. What we thought was a $50 billion hole, seems more like a crater, and we all hope it doesn't turn into a bottomless pit.

I have one other comment I would like to make, and that is, Mr. Chairman. A number of us are very concerned about the crime in the S&L industry. Senator Wirth and I and others have expressed real concern that Congress has not appropriated all of the $75 million that we authorized in the S&L bill. Only $50 million was appropriated, and it was appropriated very late. It was appropriated late last year, and as a result there is some 80 thousand cases that are in the backlog of the Justice Department, and another 8 thousand of them being sent over there every month.

And I just want to go on record that while that doesn't directly affect the work of the Oversight Board, it is, nonetheless, of great concern to many of us on this committee. Thank you, Mr. Chairman.

The CHAIRMAN. Let me say, Senator Heinz, that is a very important issue. The legislation appropriated, or authorized $75 million a year for each of the 3 years, and we have not had a request for that. If some of us think that full amount ought to be spent, then this would be a great opportunity for those witnesses who are here today if they feel that way to so indicate, because I would like to see us beef that up to the full amount.

Senator Wirth?

Senator WIRTH. Thank you very much, Mr. Chairman. I want to welcome the generals here to this endeavor that we are embarked upon. I hope, Senator Heinz, we will be able to get the full funding for that effort. We might be able to try it in an emergency supplemental, which should be on the floor tomorrow.

Mr. Chairman, thank you very much, and I have a statement I will put in the record and leave you alone from here.

The CHAIRMAN. It will be made a part of the record.

STATEMENT OF TIMOTHY E. WIRTH

Senator WIRTH. Mr. Chairman, I would like to thank you for holding these hearings and thank the members of the RTC Oversight Board for appearing before us today to discuss this subject.

The S&L debacle is arguably the largest financial crisis since the Great Depression. Losses are mounting at a rate of several million dollars a day and resolving the S&L crisis will be among the most expensive undertakings in U.S. history. The projected cost of this effort has been steadily increasing, with the most recent General Accounting Office estimate reaching $325 billion, well over $1,000 for each person in the United States.

This is a very important oversight hearing, Mr. Chairman. These hearings will enable the committee to monitor the progress of the savings and loan rescue plan, particularly the role of the Resolution Trust Corporation [RTC].

There is no single culprit responsible for the widespread losses experienced by S&L. Instead, the causes of the crisis are complex and varied. Forbearance and inadequate supervision by regulators, major downturns in regional economies, imprudent industry responses to deregulation, and fraud and insider abuse by thrift owners and management all contributed significantly to the problem we now face. The debacle is a colossal mess and I have found that the more you learn about it the more daunting it looks.

We must examine all the factors that contributed to thrift losses so we can avoid a recurrence of the problems that have plagued the industry and vigorously pursue criminal activity that led to taxpayer losses. Nevertheless, the main task has to be to clean-up this problem, and to clean it up at the lowest possible cost to the American taxpayer. The RTC will do much of this work.

Last year, the administration got off to a good start by proposing the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 [FIRREA]. President Bush recognized that we faced a very significant problem and proposed legislation, promptly acted upon and improved by the House and Senate, that offered a good first step at resolving the savings and loan industry's problems. I did not support every element of the President's legislation, disagreeing, for instance, with it's off-budget financing scheme and the plan to allow the Chairman of the Federal Home Loan Bank Board to become Director of the Office of Thrift Supervision [OTS] without Senate confirmation. Nevertheless, I thought the President's plan, on balance, was worthy of support.

Unfortunately, in recent weeks and months, I have become concerned by the administration's implementation of FIRREA. The S&L crisis deserves to be a high priority. Yet it seems that the administation has not been giving the S&L crisis the urgent attention that it requires. A variety of factors have led to this conclusion. These include the sluggish pace of resolutions of failed institutions, the slow pace of asset sales and the circumstances surrounding the resignation of Daniel Kearney as chief executive of the Resolution Trust Corporation [RTC] Oversight Board. These events raise concerns about the level of coordination between the various agencies involved in the S&L rescue operation and the lack of overall guidance from the administration. Too often, it seemed like no one was in charge or, worse, that several people thought they were.

I also found the administration's protracted delay in filling many of the positions related to the S&L bailout particularly troubling. The administration still has not appointed all the members of the Federal Housing Finance Board, leaving the Secretary of Housing and Urban Development as the only member of that body. The Regional Advisory Boards created under FIRREA to advise the RTC have also not been filled. The President waited more than 6 months after FIRREA's enactment, to name the two public members of the RTC Oversight Board, which is supposed to determine the policies guiding the RTC in its efforts to close or merge insolvent S&L's and liquidate remaining assets. Finally, the administration knew of M. Danny Wall's departure as Director of OTS for nearly 4 months before naming a replacement, 2 days after a judicial decision forced the issue.

I have also been deeply troubled by the administration's failure to request adequate funding to investigate and prosecute criminal activity related to thrift failures. Last year in FIRREA the Congress authorized $75 million annually for 3 years for this purpose. However, the administration requested only $50 million for the current fiscal year and did not specify its request for next year. Fraud and other criminal activity contributed significantly to the S&L crisis and it is plain our law enforcement officials do not have adequate resources to investigate and prosecute criminal activity in this area.

Not only do taxpayers rightfully expect the Federal Government to vigorously pursue individuals whose illegal activities contributed to the industry's losses but we must do so to send a message of "never again" to those involved in the financial industry. We cannot let those in the financial services industry believe the Government will cover any loss—no matter how big—and then let the perpetrators go unpunished.

All of these elements have contributed to my reservations about the progress of the plan to resolve the problems facing the thrift industry and the deposit insurance fund. I am concerned that the administration has simply not given this matter priority and attention commensurate with its cost and importance. I am also concerned that the overall structure of the President's S&L rescue operation is too cumbersome and has contributed to the slow progress thus far. The wide variety of individuals and agencies involved obscures responsibility and makes it difficult to reach swift decisions and act promptly.

The present structure has been described as providing two heads for the RTC. This arrangement makes it difficult for the RTC to act quickly with one voice and leads to confusion over who is actually in charge of the corporation. The early months of the RTC saw conflicts between the two boards. The confusion and disarray were among the factors that led to Daniel Kearney's resignation as President of the Oversight Board earlier this year.

Many of the problems that we have seen this year may be attributed to the growing pains that can be expected at the start of any project of this scope and magnitude. I continue to have some concerns about the cumbersome structure of the President's plan. I look forward to hearing the Oversight Board discuss the RTC's progress and problems to date, and its prospects for the future.

The CHAIRMAN. Senator Mack.

Senator MACK. Thank you, Mr. Chairman. I think at this point I will just pass, and look forward to the testimony.

The CHAIRMAN. Very good. Senator Dixon.

Senator DIXON. Mr. Chairman, I have a statement I would appreciate your putting in the record.

The CHAIRMAN. Without objection.

STATEMENT OF SENATOR ALAN J. DIXON

Senator DIXON. Mr. Chairman, I am pleased to be here this morning as the Senate Banking Committee continues its oversight of The Resolution Trust Corporation [RTC]. I am pleased to see Secretaries Brady, Kemp and Chairman Greenspan here today, along with the two independent Board Members Robert Larson and Philip Jackson, who have been on the job for only about 1 month.

We all recognize the enormity of the task before the RTC. Although I might not have designed the same structure as the administration did, I do want to take advantage of the presence of the Oversight Board to ask some tough questions.

First, have the initial delays been overcome? The administration should have prepared the way so that the Oversight Board and the RTC could have hit the ground running last August. That was not the case. The pace of thrift resolutions and asset dispositions has been disappointing, to say the least. Are enough of the people and procedures now in place so that asset sales can speed up?

Second, we are not prosecuting enough crooks, and everyone needs to do their part. When the RTC reviews failed thrifts, does it routinely look for actionable cases of fraud and abuse? Are suspicious cases automatically turned over to Government prosecutors or lawyers to sue for civil recovery? Even if the money cannot be recovered, thieves should be prosecuted and put in jail. Is the RTC doing its part?

Third, do we know any more about the costs? Estimates of the costs over the next 40 years have been wildly divergent. Can the Oversight Board at least give us a better picture of the costs over the next 3 years? How will those costs on a cash flow basis affect the budget? The administration should fully explain these figures to the American people.

Beyond that, I would just like to observe that I am sure members here who are witnesses understand that my friend, the Senator from Colorado, and this Senator made an effort to take $30 million that is contemplated to be spent for promoting tourism in Panama, to use it for financing additional prosecutors and investigators to help to prosecute those people guilty of criminal activity and fraudulent activity in connection with the failing thrifts.

I think my friend from Colorado and I will assist in a variety of other ways to find $25 to $30 million for that purpose. We had a majority in the Senate, but not the necessary 60 votes to persist under rule 302, B section, 302(b), but we are going to pursue that, and I want to also say that the Senator from Colorado, this Senator, and the Senator from Florida, Senator Graham, will offer an amendment to the crime package on the floor now to authorize a special prosecuting and strike force in connection with fraud, mismanagement, corruption, and things of that kind that have taken place, and I would urge the witnesses here, Mr. Chairman, leaders in this administration, to consult with the President and others about the fact that we find as we go about the country that people are concerned about the fact that prosecutions are not going forward in an expedited way, and I am satisfied that many in the Senate share that view and some of us will persist in seeing to it that something is done to authorize the appropriate people to do the job, and to appropriate the necessary funds to see that the job is done well.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Dixon.

Senator Roth.

Senator ROTH. Thank you, Mr. Chairman. There is a great deal more interest in today's hearing than there was on January 31, 1990, when the RTC Oversight Board appeared before us. And the reason is that the committee then was reviewing the progress of the efforts to resolve the S&L crisis. Today, the committee has become a major factor in the gripping drama of whether the President can be forced to break his campaign pledge of no new taxes. Rather frequently, I get the impression that for some the very purpose of political life is to raise taxes.

Now, if one's purpose is to raise taxes, the opportunity is at hand. If future borrowing by the RTC either for working capital or to satisfy net losses is treated on budget, the Gramm-Rudman-Hollins deficit becomes rather large, far greater than the reach of any piece dividend or other probable program cuts.

In view of the insatiable desire on the part of some to raise taxes, I wonder whether the issue may be rationally debated. It was a little over a year ago when the committee heard testimony that the net losses from the S&L disaster had been discounted by the market, and that the missing funds of insured depositors could be paid back by the Government without any threat of inflation, because the missing funds were already counted in the money supply. On that basis, the administration and Congress decided that the net losses for 1990 and 1991 could be treated off budget.

The question of borrowing on a temporary basis for working capital should be easier to resolve. Assets acquired by the RTC must be marked down to fair market value. Once marked down, the RTC may borrow up to 85 percent of that value. When the assets are sold, the debt is paid off. If the assets sell for less than 85 percent, the difference would be a net loss and paid out of the $50 billion raised for net losses.

The borrowing for working capital and RTC asset sales are, therefore, by definition, a wash. The trick question is whether the wash occurs within the same fiscal year.

I imagine there are some in Washington who dreams of the opportunity to count the borrowing on budget in 1 year to force an increase in taxes, and hope that the return on sales falls within the out years, so that there are even more funds to finance new programs. Well, rather than striving to raise taxes, we should be looking for ways to curb the S&L losses. In yesterday's Wall Street Journal, I submitted a possible proposal. I shall not read it at the present time, Mr. Chairman. I would ask that my full statement, including the Wall Street Journal article, entitled: Use Treasury Securities to Cap S&L Debt, be included in the record.

The CHAIRMAN. Without objection.

[The prepared statement of Senator Roth and the Wall Street Journal article follow:]

Statement of William V. Roth, Jr.

RTC Oversight Board Hearing
May 23, 1990

Mr. Chairman, there is a great deal more interest in today's hearing than there was on January 31, 1990, when the RTC Oversight Board appeared before us. The reason is that, then, the Committee was reviewing the progress of the effort to resolve the S&L crisis. Today, the Committee has become a major factor in the gripping drama of whether the President can be forced to break his campaign pledge of no new taxes. Rather frequently I get the impression that, for some, the very purpose of political life is to raise taxes.

If one's purpose is to raise taxes, the opportunity is at hand. If future borrowing by the RTC, either for working capital or to satisfy net losses, are treated on budget, the Gramm-Rudman-Hollings deficit becomes rather large, far greater than the reach of any peace dividend or other probable program cuts.

In view of the insatiable desire on the part of some to raise taxes, I wonder whether the issue may be rationally debated. It was only a little over a year ago that the Committee heard testimony that the net losses from the S&L disaster had been discounted by the market and that the "missing" funds of insured depositors could be paid back by the government without any threat of inflation because the "missing" funds were already counted in the money supply. On that basis the Administration and the Congress decided that the net losses for 1990 and 1991 could be treated off budget.

The question of borrowing on a temporary basis for working capital should be easier to resolve. Assets acquired by the RTC must be marked down to fair market value. Once marked down, the RTC may borrow up to 85% of that value. When the assets are sold, the debt is paid off. If the RTC were fully extended and the assets sold for less than 85%, the difference would be a net loss and would be paid out of the $50 billion raised for net losses.

The borrowings for working capital and RTC asset sales are, therefore, by definition, a wash. The trick question is whether the wash occurs within the same fiscal year. I imagine that there are some in Washington who dream of the opportunity to count the borrowing on budget in one year to force an increase in taxes and hope that the return on sales falls within the out years so that there are even more funds to finance new programs.

That dream is my nightmare. As one study prepared for me by staff on the Joint Economic Committee demonstrated, for every new tax dollar raised by Congress, spending increases by $1.58. I am opposed to raising taxes. It is not the solution.

Rather than striving to raise taxes, we should be looking for ways to curb the S&L losses. In yesterday's Wall Street Journal I submitted a possible proposal. The main purpose of my proposal is to cause some new thinking on the subject. While my proposal would not necessarily save money in fiscal year 1991, I would hope that it would not be dismissed for that reason. If successful, my proposal would end the perpetual financing of the S&L bailout which is the probable result of the current plan. The current plan is to sell assets as soon as practicable at their market price. I applaud that. The additional losses resulting from such sales will eventually push us beyond $50 billion in net losses. These additional losses will be financed in the traditional manner, through various Treasury securities, which on maturity will be refinanced ad infinitum.

My proposal would, in a sense, combine the sale of assets and the sale of securities in one package. Each asset would be guaranteed to rise in value to equal the sum of the current values of the asset and the security. The purchaser would have to earn a return on the asset and would be paid a return in the form of interest on the security, thereby realizing an enhanced return on his purchase from the beginning. For this the purchaser would be expected to pay the fair market value for the asset and for the security. Because of the guarantee, the package would, in my opinion, be attractive to institutional investors. In contrast, I do not believe they are very interested in the current plan.

I have confidence that in some period of time, whether it be 8 years or 15 or 20, whatever the term of the guarantee, the assets will rise to full value. Put another way, I am confident that, in time, inflation will assist rebounding values so that the government will not have to pay on its guarantee and the endless cycle of refinancing will be terminated. Moreover, I believe that my proposal will produce more purchasers today than will the current plan.

During the period for questioning, I hope to explore this issue with this distinguished panel. Thank you, Mr. Chairman.

THE WALL STREET JOURNAL TUESDAY, MAY 22, 1990

Use Treasury Securities to Cap S&L Debt

By WILLIAM V. ROTH JR.

Perhaps the most significant and least appreciated fact of the savings and loan disaster is that the size of the taxpayers' bill—whether it be $50 billion or $250 billion—will depend on the government's ability to sell the assets of the failed thrifts.

Astronomical figures for the cost of the bailout, which grab the headlines in the face of the uncertainty that surrounds this endeavor, may even be on the low side. What is often overlooked is that the principal sum is a net figure, the difference between government liabilities (what it must pay insured depositors) and government receipts (what it collects from the sale of assets). Thus a price tag of $50 billion is an estimate that the government will pay out that much more than it receives.

The government has yet to demonstrate its ability to sell repossessed assets. In fact, some may even question whether it has ever demonstrated the desire to sell such assets. That is why the attitude of L. William Seidman, chairman of the Federal Deposit Insurance Corporation and Resolution Trust Corporation, is so refreshing. He has made it clear he is ready to deal now.

'Opportunity' Assets

Of course, the market is very depressed. Congress made the thrifts and their assets very unattractive to buy. For the most part, the government will have to sell the thrifts' assets to help pay off insured depositors. While performing assets may go for a fair return, who will buy that vast sea of bad assets, which Mr. Seidman refers to as "opportunity" assets? He has correctly characterized the sale of illiquid "opportunity" assets as "where our game will ultimately be won or lost."

I am greatly concerned that there will not be a market for these bad assets at a price that will generate necessary returns to hold taxpayer burdens in line with government projections. If, for example, the government has to pay out $450 billion to insured depositors, then it must collect $400 billion for the assets in order to hold losses to $50 billion, as originally estimated in the S&L legislation.

Mr. Seidman states: "If a property doesn't sell, it probably will be because we're asking too much and we'll have to reduce our price." But if we collect only $300 billion for the assets, the taxpayer is on the hook for $150 billion, not just $50 billion. The taxpayer, of course, foots the bill for the losses.

If we continue on this path, the assets probably will not sell at the price necessary to limit taxpayer's liability to $50 billion. Then, whatever the ultimate loss, the government will issue Treasury securities to raise the cash to pay off insured depositors and the taxpayer will pay billions in interest and principal.

If the interest were offered to asset purchasers as a guarantee of income rather than to purchasers of Treasury securities, the worst that could happen is a wash.

But wait! It doesn't have to be that expensive. If the interest were offered to asset purchasers as a guarantee of income rather than to purchasers of Treasury securities, the worst that could happen is a wash and the best is that the principal payment would be saved.

My idea would work like this: Suppose that the RTC assets (real estate assets, in this example) had to be sold for $400 billion, close to book value, to keep the taxpayer loss down to $50 billion. But the market is depressed and the fair market value today for all the assets is, let us say, only $300 billion. The government would sell RTC assets coupled with a special Treasury security in an amount to bridge the gap between the low selling price of the asset and its "necessary" value to keep taxpayer losses down. In this example, the special securities issued would total $100 billion, the difference between $400 billion and $300 billion.

The purchasers of the asset and the special security would have several options. They could hold both, sell both, or part with one. The holders of the security would receive interest payments for 20 years regardless of the value of the connected asset. At maturity, if the asset had appreciated to at least the necessary value, the government would not be obligated to pay anything. If the asset had depreciated, the government would pay the principal in full, as it would on a mature Treasury security. If the asset had appreciated some, but not up to necessary value, the government would pay the difference between its actual value and the necessary value.

How would its actual value be established? Any sale of the asset at or above the necessary value during the 20-year period should absolve the government of paying the principal on the security. If no such sale occurred, then any arm's-length sale within the three years preceding maturity would be conclusive. Absent such a sale, the holder of the security who believed that the government owed money to him could establish that fact by requesting, at his expense, a government appraisal of the value of the connected asset. If would not be necessary for the security holder to own the connected asset.

In my opinion, the occasions for government payment would be rare. If some skeptics do not share my faith in rising RTC asset values (now very depressed) or in the march of inflation, the 20-year period could be extended to 30 or even 40 years. Extensions of time would provide greater assurance against the payment of principal but would require commensurate interest payments over a longer period.

The purchasers of the asset and security package from the RTC would be getting a fair value—an asset guaranteed by the government to rise in value and, in addition, interest payments for a period of years. The purchaser would have complete freedom to sell all or part of his investment. The government would obtain the necessary cash to pay off depositors now while also profiting from the appreciation of assets it has sold.

Most important, the government would be able to raise the money to cover the shortfall the RTC is now experiencing without, in all likelihood, having to pay it back. Since this shortfall may well be in the hundreds of billions of dollars, my proposal would save that amount over the costs of traditional government financing.

Making a Market

I have written to the RTC Oversight Board to suggest that the board do some creative thinking to "make a market" for RTC assets. The members' response, while thoughtful, basically rested on the belief that there currently exists a healthy market for RTC assets. Recent news stories show that belief may be crumbling. Moreover, there appears to be some skepticism regarding the wisdom of any enhancements, primarily due to the negative reactions to the December 1988 Federal Savings & Loan Insurance Corporation deals.

The RTC has set asset sales for the next few months. My guess is that if the assets, particularly the real estate assets, are sold at all, they will go for distressed prices. And nothing very creative is planned to save the taxpayer. Mr. Seidman has been quoted as saying that if there is no sale at lower prices, then "we scratch our heads."

It is not uncommon for the seller of an apartment or office building to guarantee the buyer a year or two of full occupancy when the buyer has doubts about near-term prospects but confidence in the more distant future. Such enhancements are not giveaways, but simply a private-sector method for creating a market. We need to do the same.

Sen. Roth (R., Del.) is a member of the Banking Committee.

Senator **Roth**. I, of course, want to ask some questions when it comes to my turn.

The **Chairman**. Very good. Senator Gramm.

OPENING STATEMENT OF SENATOR GRAMM

Senator **Gramm**. Mr. Chairman, let me thank you for holding this hearing. I guess it is fair to say we are eager to hear what our panel has to say. I don't know if we are going to be happy about it once we have heard it. While clearly most people in the media are here to report what the new cost figure is, my fear is that the public is already numbed by the fact that the number is so big, that making it bigger really doesn't have a lot of meaning.

So, I know we have to be concerned about how deep the hole is, but I think it is also very important that we focus on what we are going to do about it.

I am a lot more interested in hearing today how you are going to minimize the cost, than I am about how big the costs are. In terms of how big the cost is, in a sense that is history. That is what has got to be filled. What we do to begin to fill it quickly and boldly is going to affect the ultimate size of it. Being engaged in the budget summit, I can say that we have spent three long sessions talking about how bad the problem is, and we have yet to hear a word uttered as to what we are going to do about it.

So, I hope that we can hit a happy balance here. Go through all the misery, put it out on the table, so we can all read about that tomorrow in the paper. I hope we can also spend the time that we have beyond that talking about what can we do to help you do something about it. Minimize the losses. What changes do we need in the original bill? We have now been limping along for several months. Do we need changes in the existing law to help you facilitate asset sales?

What can we do to make the losses lower? That is basically what I want to hear, and I pledge to you my support to fund our effort to try to recover money. Anything that we can do to minimize the losses, I want to do that. But I don't think we ought to be totally occupied with just spreading the misery. I think our focus ought to be on trying to reduce it.

The **Chairman**. Very good. Let me now introduce our witnesses this morning. They are Nicholas Brady, who is the Chairman of the Oversight Board of the RTC, and Secretary of the Department of Treasury. Jack Kemp, who is a member of the Oversight Board of RTC and Secretary of the Department of Housing and Urban Development. Alan Greenspan, who is a member of the Oversight Board of the RTC and Chairman of the Board of Governors of the Federal Reserve System, and our two private sector members, Robert Larson, who is a member of the Oversight Board of the RTC, and Philip Jackson, also serving as a member of the Oversight Board. They are accompanied today by Mr. Taylor, who I know has been functioning as the CEO of the RTC Board. So, we are pleased to have him here with us today as well.

Before I call first on Secretary Brady, Budget Chairman Sasser, a member of our committee, has just arrived. Senator Sasser, did you have an opening comment that you want to make?

Senator SASSER. No, Mr. Chairman. I am just eager to hear the witnesses this morning, and wish to welcome them before the committee.

The CHAIRMAN. Very good. Before we start, I have a statement from Senator Graham to be inserted for the record.

OPENING STATEMENT OF SENATOR BOB GRAHAM

Senator GRAHAM. Mr. Chairman, on April 6, 1990, the Government Accounting Office testified before this committee that the cost to the Government of the savings and loan bailout could become a $400 to $500 billion problem if the economy works against you. That is a devastating statement as to the severity of the problem with which we are faced. It is a call to arms for all people involved, from the administration to the Congress to the industry to take whatever actions are necessary in order to suture this hemorrhaging financial condition.

Last year I was concerned about the administration's economic assumptions upon which the Treasury's plan was based and particularly what the administration thought the ultimate cost would be. At that time, the Treasury predicted that REFCORP rates would be 9.1 percent in 1989; 7.9 percent in 1990; and 6.5 percent in 1991.

What has actually occurred is that REFCORP rates for 1990 are 8.4 percent instead of 7.9, and the Congressional Budget Office is predicting for 1991, that the rates will be 8.1 percent instead of 6.5 percent. This means that the taxpayers as opposed to the industry will be picking up at least an additional $4 billion in interest cost during the period from now until 1999.

Gentlemen, when you came before the committee in January 1990, I asked you whether you had enough resources to handle the responsibilities which you had been given collectively and individually and you all said you thought you had sufficient resources to deal with the problems. You were urged to come back to the committee with a request for additional resources if you thought you needed them. I will again be asking you this question today.

I look forward to the testimony today to learn what your plan will be to reduce the ultimate cost to the American taxpayer and what recommendations you will have that will require congressional action, and I encourage the committee to give the earliest possible attention to those recommendations.

The CHAIRMAN. Secretary Brady, as Chairman we would like to hear from you now. We will make your full statement a part of the record, and we would appreciate any summary comments that you want to present to us.

STATEMENT OF NICHOLAS BRADY, CHAIRMAN, OVERSIGHT BOARD OF THE RESOLUTION TRUST CORPORATION, SECRETARY, DEPARTMENT OF THE TREASURY, ACCOMPANIED BY JACK KEMP, MEMBER, OVERSIGHT BOARD OF THE RESOLUTION TRUST CORPORATION, SECRETARY, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT; ALAN GREENSPAN, MEMBER, OVERSIGHT BOARD OF THE RESOLUTION TRUST CORPORATION, CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM; ROBERT C. LARSON, MEMBER, OVERSIGHT BOARD OF THE RESOLUTION TRUST CORPORATION; PHILIP C. JACKSON, MEMBER, OVERSIGHT BOARD OF THE RESOLUTION TRUST CORPORATION; WILLIAM TAYLOR, ACTING PRESIDENT AND CEO OF THE OVERSIGHT BOARD OF THE RESOLUTION TRUST CORPORATION

Secretary Brady. Thank you, Chairman Riegle. My full statement, I would appreciate if you would include in the record.

The Chairman. It will be part of the record.

Secretary Brady. My oral statement is a little longer than my normal practice, which is to try and make these things as short as possible, but I think due to the complexity of the problem and its importance, if you will indulge a slightly longer oral statement, I will appreciate that.

The Chairman. Let me say we want to take whatever time is necessary today, and we don't want you to feel hurried in the slightest. So, please take whatever time you need.

Secretary Brady. Thank you. Mr. Chairman, members of the committee, we are pleased to have this opportunity to present our views on the progress to date under the Financial Institutions Reform, Recovery and Enforcement Act of 1989 [FIRREA] and to discuss the outlook for the months to come.

I address the committee this morning in my capacity as Chairman of the Oversight Board and I am accompanied by other members of the Board, Chairman Alan Greenspan, Secretary Jack Kemp, Philip Jackson, and Robert Larson. We are also accompanied this morning by William Taylor, who has served for the last several months as the Acting President of the Oversight Board, and by Peter Monroe, who will soon take over that job.

I just want to pause for 1 second here to say we are grateful for the contributed services of Bob Larson, who has spent a lifetime in the real estate business, and Phil Jackson who, of course, among his many accomplishments counts some years of service as a member of the Federal Reserve Board, so these two gentlemen have made an enormous contribution to our deliberations, and we appreciate it.

This testimony will cover our efforts since the enactment of FIRREA, 9 months ago. As we proceed, we do so under three principles which have guided us from the start.

First, we will make sure that the millions of men and women who put their savings in savings and loan institutions are protected to the full extent of their Federal Deposit Insurance.

Second, we will do all within our power to do the job with the least cost to the taxpayer.

Third, we will aggressively pursue and prosecute the crooks and fraudulent operators who helped create the S&L problem. There are many who are impatient to wish these unpleasant problems behind us.

We must remember, however, that it took over a decade for the thrift problem to become so costly and so difficult to fix. The enactment of FIRREA less than a year ago was only the beginning of the solution. We still have a long way to go before we reach the end.

This morning I will present a summary of major issues covered in our prepared testimony and ask that the full statement be placed in the record. As with the written statement, my comments this morning will cover three areas: A brief look back at the circumstances which led up to the enactment of FIRREA, a report on the progress from last August to the present, and finally a look forward to consider the question of resources.

Before we do so, we should face squarely the fact that the real estate market in a number of areas in the United States is in a weakened state, and it has become particularly so in the last year.

This affects every aspect of the problem we face, especially the job of estimating the size of the problem. The condition of the real estate market affects the number of institutions which failed, the value of their assets, the speed in which assets can be sold and, thus, the ultimate cost.

FIRREA requires that we provide an estimate of the remaining exposure of the U.S. Government from institutions which will come under the control of the RTC. We have attempted to do so. Note that such estimates are highly uncertain, because they require market predictions which are themselves highly uncertain. For that reason, no one should assume that the estimates presented today will not change. They will.

Looking back. As this committee knows well, the problems we are wrestling with today have roots which reach back over many years. The savings and loan problem was there to greet President Bush when he took office in January 1989, and he wasted no time in responding. Less than a month after taking the oath of office, the President came forward with a plan, and made it one of his highest priorities to enact it into law.

You in the Congress and we in the administration worked together last year as architects of a plan to repair the damage and reform the system. With your leadership, Mr. Chairman, and Senator Garn, and that of your committee, we took an important step toward resolving this serious problem.

It is important to bear in mind that we undertook this effort with a single purpose in mind: protecting depositors. We are not bailing out shareholders. We are not bailing out management. We are not in this to preserve institutions. In fact, many will be lost. Monies are spent to protect depositors.

It was just over a year ago that Congress took up consideration of FIRREA. This committee marked up the administration's bill in record time, preserving the essence of the plan, but adding its imprint. Just a few months later, FIRREA was enacted and the machinery was in place.

Let me now turn to a report on the progress of the RTC. I will briefly cover three major areas. Case resolutions, assets acquired and sold, and enforcement efforts. I will refer you to the written statement for discussion of other areas of concern, important areas, notably affordable housing and minority outreach efforts.

It is important to remember that a key purpose of FIRREA is to provide the money and mechanism to remove insolvent and failing thrifts, so that the industry which remains can compete successfully and safely in the financial market place. The evidence is that FIRREA is working. Outside of the universe of RTC institutions, the industry which remains is profitable. It has on the average more than 3 percent tangible capital, and is growing by adding deposits.

Let me now turn to the status of case resolutions. When RTC started its work on August 9, 1989, there were 262 institutions in conservatorship. Since August through mid-May, the RTC has resolved 93 cases, while adding 161 institutions to the case load. That left the RTC, as of May 14, 1990, in control of 330 conservatorships. There has been discussion about the RTC's relatively slow start in case resolutions. One sub-factor which certainly affected the pace of resolutions during the first several months is that it takes time to build an organization, particularly one so large and with so difficult a task as the RTC. But the major problem faced by the RTC in trying to resolve cases is that there simply has not been that many interested buyers for the assets taken over, especially for whole thrifts.

RTC's concern about a pile up of retained assets of failed thrifts seems to have been another factor affecting the pace of resolution. The RTC recognizes the difficulty of managing and disposing of assets and will, therefore, attempt to pass as many assets as possible to private sector acquirers. We certainly share that as a goal, but tend to support the quicker pace of resolutions while moving on a separate track to return the assets quickly to the private sector.

We have encouraged the RTC over the last several months to place greater reliance on liquidations, including deposit transfers as a method of resolution. The RTC third quarter plan reflects such a shift in emphasis.

With policies in place, and the lessons of nearly 8 months of operation, the RTC in March laid out an ambitious schedule of case resolutions for the third quarter of fiscal year 1990. The plan calls for resolving 141 institutions, with assets totaling $50 billion between April 1 and June 30, 1990. The Oversight Board endorsed the third quarter plan, and approved the funds necessary to carry it out. We recognize that the RTC has set a challenging goal for itself in the third quarter plan, and we will continue to provide the support needed to allow the maximum possible success.

Finally, we are concerned about the effect of the conservatorship program. In essence, the Government warehousing of private sector assets on franchised values. The RTC shares these concerns and, therefore, has developed the idea of the accelerated resolution program. In introducing the concept, Chairman Seidman referred to the deterioration in value of institutions which remain under the control of the Government for a prolonged period, and made the case for early intervention.

We support this goal. That is, to deal with an institution when the resolution cost the least, but to continue to focus on the need to resolve the existing conservatorship case load.

The next issue is asset disposition. There are two groups of assets under the control of the RTC. Those in conservatorship and those in receivership. As of March 31, 1990, there were 350 institutions in conservatorship, with gross assets in book value of $159.9 billion. As of the same date, there were 52 receiverships with assets totaling $13.3 billion. Through March 31, 1990, the RTC has reduced the volume of assets under its control, including both conservatorships and receiverships, by nearly $42 billion through March 31. We recognize that a large portion of this total represents the sale of the most marketable assets, but are, nonetheless, pleased to see this level of reduction.

While the RTC has compiled a substantial record on sales from conservatorships, there has been less progress in disposing of receivership assets. To some extent, this is understandable, because the receivership assets are the most troubled. The Oversight Board and the RTC, however, are anxious to establish a record of steady and solid progress in the sale of assets.

The CHAIRMAN. Mr. Secretary, excuse me just 1 one moment if I may. We have just had a vote start, and I know there is keen interest on the committee on each of the points you are making, and very particularly the issue of what the asset disposition plan looks like. I know you are just about to get into that, and I think rather than have members leaving for the vote, that maybe what we ought to do is right now recess for about 10 minutes.

I would like to ask the members, if they would, to come back immediately to the committee so we minimize the interruption. This is a very important hearing, and I want to make sure that we have sufficient time with our witnesses.

With that, we will go into recess for about 10 or 12 minutes, and we will be back very shortly.

[Recess taken to vote.]

The CHAIRMAN. Before resuming with your statement, Secretary Brady, we have been joined by two other Senators, and I want to just call on them briefly for any opening comments they wish to make. Let me start with Senator Sanford.

Senator SANFORD. Mr. Chairman, I think I will not take the time to go through my opening statement. I do express the same kind of concern that all of you are here to express. Looking for ways to conserve and get the most out of the property that we have got to dispose of. And I thank you for being here. It is an extremely difficult challenge. It is so massive that it is almost beyond management, but I certainly hope we can keep working toward a proper solution that minimizes the cost to the public, and we certainly will be looking for ideas and very cooperative as best we can, and I will just put my statement in.

The CHAIRMAN. Very good. We will make the full statement a part of the record. Thank you, Senator Sanford.

OPENING STATEMENT OF SENATOR TERRY SANFORD

Senator SANFORD. Thank you, Mr. Chairman, and I would like to join my colleagues in welcoming our very distinguished panel of witnesses, appearing before us for the semiannual review of the operations of the Resolution Trust Corporation.

There is no doubt that all of the concerns and issues to be raised this morning are overshadowed by the tremendously disconcerting news that massive new borrowings are required to address this problem. The amounts being discussed, whether $80 billion or $140 billion or whatever the figure might be, point out the huge degree to which the administration underestimated the cost of this problem and raises again a host of issues of how we can best raise this money. The call for this level of additional funding obviously has tremendous implications for our budget and budget deficit, and may raise additional concerns regarding interest rates.

In addition to these strong concerns over such large new funding needs, I remain very troubled that things are moving too slowly, that bureaucratic overlaps continue to bog some things down, and that the problem continues to grow much bigger than we anticipated. I was, however, encouraged to see the recent declaration by the RTC that more aggressive efforts to move properties are beginning, as well as the announcement of the ambitious plan to resolve 141 institutions by June 30 of this year.

Underlying those efforts, though, is the stark reality that the vast majority of the resolutions carried out so far involve so-called clean bank transactions or other types of deals in which the RTC may sell the deposits and certain healthy assets, but the lions share of the bad assets are retained by the RTC. Thus, while we proudly claim that we are resolving a large number of the cases and making great progress, the more difficult job of disposing of these bad assets remains ahead of us. I am very concerned about our ability to obtain a decent return on the disposal of those assets and about the costs we will incur the longer we are forced to carry them.

I know I share a number of the concerns of my colleagues regarding the issues of the overall structure and relationship between the Oversight Board, the RTC Board, the RTC itself, the FDIC and the OTS, as well as concerns regarding the funding mechanism for this effort, the overall cost we will be facing and the disgruntlement of many of our housing finance agencies and housing groups regarding the affordable housing program.

In addition, I am particularly concerned about an issue that has arisen in North Carolina and is likely to come up in a number of other States concerning environmentally sensitive or ecologically significant properties. As you are aware, FIRREA requires the publishing of a list of all properties with "natural, cultural, recreational or scientific values of special significance," but that there are difficulties with this inventory.

While I can understand that the RTC does not have the expertise to carry out these surveys, I am told that the Fish and Wildlife Service has offered to conduct such assessments, but the RTC has yet to act on that offer. While this issue may be small in comparison to the overall goals of the Oversight Board, I believe it would be a tragedy if properties such as the rare maritime forest of the Nags Head Woods in the Outer Banks of North Carolina, which Congress declared over 15 years ago to be a National Natural Landmark, are sold before any knowledgable assessment is made regarding their environmental significance.

Again, I thank the Oversight Board for the appearance this morning and look forward to hearing their report.

The CHAIRMAN. Senator Bond.

Senator Bond. Mr. Chairman, I have lots of ideas and thoughts on this, but I believe that the testimony and information of the experts will be far more informative to all of us, and I will forego a statement at this point. Thank you, sir.

The CHAIRMAN. Very good. Thank you, Senator Bond. Secretary Brady, we would like you to continue now, if you would.

Secretary BRADY. Thank you, Mr. Chairman. I will pick up at the beginning of the paragraph, if I may. While the RTC has compiled a substantial record on sales from conservatorships, there has been less progress in disposing of receivership assets. To some extent this is understandable, because receivership assets are the most troubled. The Oversight Board and the RTC, however, are anxious to establish a record of steady and solid progress in the sale of assets. It has become critically important to achieve greater progress in the area of asset sales as the number of resolutions increases. For example, we must take advantage of the opportunity to dispose quickly of assets which have a ready market, such as single family mortgages. If reasonable representations and warranties are required, as are customary in the market place, we would support the RTC in giving them.

We also support the RTC in the procedures recently adopted for determining the market value of assets and establishing prices for sales by auction. We believe that the RTC Board has taken an initial step toward dealing with appraised values which may, in some cases, overstate market values and so communicated that to the RTC during its deliberations.

We find the approach which they have taken to be responsible.

At this point, let me briefly report on progress in enforcement activities, although the Oversight Board does not have a direct role in enforcement activities. The RTC has established an Office of Investigations in Washington, and has teams of investigators throughout the country. These investigators will help to identify negligent and reckless management, fraud, and criminal conduct which contributed to thrift insolvency.

They will be involved throughout civil litigation proceedings, and will also assist the FBI and U.S. attorneys in criminal prosecutions.

Thrift regulators and institutions have made over 17,000 criminal referrals in the last 3 years, including requiring 664 institutions to enter into binding agreements terminating unsafe and unsound practices. Also including removing 150 senior officers and directors from thrifts, and forbidding them ever again to be employed by an insured thrift institution, and issuing 111 cease and desist orders to stop unsafe and unsound practices, and require restitution.

In addition, there are over 1,000 civil lawsuits seeking to recover billions of dollars from the former directors, officers and professionals, including accountants and lawyers. Criminal referrals have already resulted in prosecutions and convictions. Despite the extent of our present enforcement activities, the Government needs to do more. We must vigorously pursue those whose criminal and fraudulent activities help create the current situation.

Now, if I may, let me turn to the issue of future requirements of the RTC. Since the thrift crisis first emerged, there have been a number of sources providing explanations and estimates of the size of the problem. Each has a projection as to how many thrifts will require Government expenditures and how much the entire cleanup will cost. Some give cost estimates on a present value basis, while others give them on a cash basis. Some estimate total cost for resolving the thrift crisis, while others focused on additional funds required.

Estimates also varied on whether they include REFCORP interest costs, interest on working capital, and even the effect on Government borrowing costs. Including interest costs treats the savings and loan program differently from the vast majority of Government programs, and has the effect of dramatically increasing cost estimates.

In short, there are a myriad of estimates prepared, using a variety of methods. Of course, the highest estimates get the most attention. Let me give you our view of where things stand.

FIRREA established a funding structure which has three parts. First, it provided for the payment of prior commitments of FSLIC from the old FSLIC. At the time FIRREA was signed into law, it was estimated that the cost of winding down FSLIC, in present value terms, would be about $40 billion. It now appears that the cost will be higher than originally estimated.

Second, FIRREA provided $50 billion, $18.2 billion in appropriations, $1.2 billion from the Federal Home Loan Bank, and $30 billion from REFCORP to resolve the RTC case load. That is, insolvent savings and loans which failed during the 3 years subsequent to the enactment of FIRREA.

At the time FIRREA was enacted, there were approximately 350 insolvent thrifts with assets of about $170 billion and roughly another 150 institutions with $100 billion in assets that would almost certainly become insolvent in the near term. The $50 billion requested was based on the most credible estimated at that time, prepared by the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board, and the General Accounting Office.

Finally, FIRREA established the Savings Association Insurance Fund [SAIF] to bear the cost of thrift failures that occur after August 9, 1992. Though we did not have a firm estimate of the funds that would be required by SAIF to meet its obligations, FIRREA authorized the Treasury to provide up to another $32 billion for this purpose. The present value of these future commitments is approximately $23 billion.

At the time of the legislation, there was a great deal of uncertainty about the long term cost of fixing the problem, a difficulty which exists to this day. Let me quote from a letter which I sent to Chairman Riegle dated June 23, 1989, in response to his question about the adequacy of funds to be provided in FIRREA.

I quote,

Let me emphasize that this level of resources, no matter how thoroughly researched or widely agreed upon, is still based only on estimates. Uncertainties include the level of interest rates, the strength of the economy, as well as many other factors that could have a real significant impact on the size of the problem. As a result, the actual cost of case resolutions could be higher or lower, depending on the actual circumstances.

It is now clear the amount projected and authorized for the RTC and FIRREA will fall short of what is required. Causes of these increased RTC losses appear to fall into three different categories. Losses in individual thrifts are larger than expected. Marginal thrifts are likely to fail sooner than expected, and the total number of projected thrift failures has increased.

Why has this happened? The fact is that we now have what we simply could not have had at the time of FIRREA, actual experience with the cost of marketing insolvent thrifts and their assets. This experience with 93 resolutions has made us more pessimistic about the losses embedded in thrifts inside and outside the RTC current case load.

A number of factors have contributed to these higher projections, including ones with which this committee is very familiar. The first is a general decline in regional real estate markets, particularly commercial real estate. The fact that healthy banks and thrifts have become much more leery about taking real estate assets into their balance sheets in view of current market conditions, results in more bad assets piling up at the RTC. An additional factor is higher than projected interest rates, which translate directly into increased operating losses for thrifts in conservatorship, and indirectly into softer real estate markets.

A further factor is unexpected losses in below investment grade bonds, sometimes referred to as high yield or junk bonds, and a fifth factor is that, at least for some purchasers, thrifts just are not as attractive a franchise relative to banks as they once were.

These factors have produced not only higher than expected losses, but also an increase in the populations in savings and loans that will require attention. To some extent, this results from the fact that cases which we expected to be handled in the future by SAIF, and for which FIRREA provided $32 billion will, in fact, be handled by the RTC. These cases are merely moving forward in time.

The Office of Thrift Supervision has indicated that there are 299 institutions with assets totaling $193 billion over and above the 423 that have been in conservatorship which are likely candidates for transfer to the RTC. We cannot say for sure, however, whether all of these institutions will come under RTC control. There are another 315 thrifts with $115 billion in assets for which the future is uncertain, but which currently have positive, tangible net worth and do not require assistance. We simply do not know which and how many of these institutions will come to the RTC, and what condition they will be in when they get there.

In short, at this point in time, the number of institutions which the RTC will have to resolve is simply unknowable, yet this number drives the cost estimate.

Another source of uncertainty is the level of loss incurred by the RTC on the assets of the institutions which come under its control.

Those losses, in turn, depend on the kinds of unpredictable factors which I have described earlier. State of the real estate market, interest rates, and other market conditions.

When will more funding be needed? Even though the RTC has committed less than a quarter of the $50 billion, it could, with an aggressive schedule of case resolutions, run out of funds by the end of the calendar year, or early next year. If progress occurs at a slower pace, then RTC assets will last longer.

Of course, it would be possible to slow the pace in the hope that the market conditions will improve in the future. We believe that there has been too much speculation already. Our job is to be steady, do the work, and take no further gambles with the taxpayers money.

How much more will be needed? There are too many variables to pin a single number on it. Again, number of cases, loss on assets, interest rates, real estate market conditions, to name just a few. The most responsible course, we believe, is to consider a range of possible options. For example, a reasonable lower limit on the number of institutions which will have to be resolved, together with small, medium and high levels of losses on selling the assets of these thrifts produces cost estimates in present value terms of $89 billion, $97 billion and $114 billion. The estimates in this statement should be compared with the $73 billion provided to FIRREA already. In other words, they include the $50 billion provided for the 1989–1992 period, and the $23 billion in present value terms provided for the succeeding 8 years.

The same loss factors applied to a reasonable upper limit on the number of institutions to be resolved yield cost estimates, again in present value terms, of $99 billion, $113 billion and $132 billion. Again, these figures should be compared with amounts already provided by FIRREA, not added to them. Of course, one could make even bleaker assumptions, and make an estimate based on even higher populations of failed thrifts and even higher loss factors. This would dramatically increase the top range of the cost estimate. While such a scenario is theoretically possible, we believe it to be unlikely under any reasonable set of economic conditions.

All of this suggests that there are too many unknowns to provide a single estimate of the ultimate costs. Taking into account all of the uncertainty, and all of the variables, it appears that the cost of resolving institutions which are likely to come under the control of the RTC will be in the approximate range of $90 billion to $130 billion. Once again, these figures are in present value terms, and include the amount already provided in FIRREA. How should additional funds be raised? The Federal Home Loan Bank System does not have the capacity to back substantially more resolutions, REFCORP borrowing. Additional resources will have to come from Treasury funds.

Finally, how should these funds be provided? There appear to be two basic choices: Either provide a specified amount to cover some or all remaining losses, or provide the RTC such sums as are reasonably necessary to complete the job.

No matter how the funds are provided, it will not change the cost of resolving the S&L crisis. This is not a discretionary activity. The Government's deposit guarantee must be fulfilled. There is precedent in the Federal Budget for providing indefinite authority to fund mandatory activities. Congress can choose to provide resources to the RTC in increments, but that means having to face the prospect of returning at relative short intervals as markets change and along with them, the estimates.

The RTC faces another important constraint in the form of FIRREA's obligation limitation on the note cap. This is the provision which limits obligations, most notably working capital borrowing, to the amount of unused REFCORP authority, cash on hand, and 85 percent of the fair market value of the assets held by the corporation. The RTC is likely to run up against the obligation limit, the working capital limit, as soon or even sooner than it reaches the $50 billion in losses.

If the RTC cannot raise additional working capital and the cost of acquiring assets exceeds the amount generated from sales, it cannot proceed with resolution.

The Oversight Board intends to work with Congress and the administration to develop an approach which will provide the RTC the resources necessary to finish the job, while maintaining adequate controls.

Given the enormous significance of this issue for the Federal Budget, we believe this is a matter which should be considered in the current budget discussions between the administration and congressional leadership.

In closing, we would echo a view expressed recently by Chairman Seidman. This is a long, hard job, and it will take an extended period of time to finish it. However, we stand behind the commitment made by President Bush in his first weeks in office: protect the depositors; clean up the industry at the least cost to taxpayers; and punish the criminals.

Thank you, Mr. Chairman.

[The complete prepared statement of Secretary Brady follows:]

OVERSIGHT BOARD
RESOLUTION TRUST CORPORATION
Washington, D.C. 20232

STATEMENT OF SECRETARY NICHOLAS F. BRADY
ON BEHALF OF THE
OVERSIGHT BOARD
OF THE RESOLUTION TRUST CORPORATION
BEFORE THE
SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

MAY 23, 1990

Mr. Chairman, members of the Committee, we are pleased to have this opportunity to present our views on the progress to date under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) and to discuss the outlook for the months to come.

I address the Committee this morning in my capacity as Chairman of the Oversight Board and am accompanied by the other members of the Board: Chairman Greenspan, Secretary Kemp, Philip Jackson, Jr., and Robert Larson. We are also accompanied by William Taylor, who has served for the last several months as the Acting President of the Oversight Board.

Speaking for a moment for the three charter members of the Board, let me tell you how pleased we are to have been joined by two such able individuals as Philip Jackson and Bob Larson. We are all grateful for their willingness to sign on and of course for their experience and judgment.

This testimony will cover our efforts since the enactment of FIRREA nine months ago. We are dealing with a moving target, made greatly more expensive by a weakening real estate market and constantly changing economic conditions. It is not susceptible to easy answers or simple solutions. The problems are complex and massive -- as we knew they were a year ago as we worked together to adopt legislation. If anything, the experience of nine months has revealed that the task is even more formidable than any of us then imagined.

As we proceed, we do so under three principles which have guided us from the start:

- First, we will make sure that the millions of men and women who put their life savings in savings and loan institutions are protected to the full extent of their federal deposit insurance.
- Second, we will do all within our power to do the job at the least cost to the taxpayer.
- Third, we will aggressively pursue and prosecute the crooks and fraudulent operators who helped create the S & L problem.

It is important to bear in mind that money spent on the savings and loan crisis is spent with a single purpose in mind. The United States government made a promise to millions of Americans. We promised to protect their savings if deposited in a federally-insured savings and loan. Now we make good on that promise.

We are not using taxpayer dollars to bail out any thrift institution, their owners, or the savings and loan industry in general. We are living up to the government's end of the agreement represented by federal deposit insurance.

There are many who are impatient to wish these unpleasant problems behind us. We must remember, however, that it took over a decade for the thrift problem to become so costly and so difficult to fix. The enactment of FIRREA less than a year ago was only the beginning of the solution; we still have a long way to go before we reach the end.

There are no magic solutions. We cannot predict with certainty the amount of money or the amount of time it will take to finally resolve this problem. What we can promise is to seek sound advice, use common sense, and see that the problem is effectively managed.

Our statement first takes a brief look back at the circumstances which led up to the enactment of FIRREA. It then provides a report on progress from last August to the present, covering the following areas: case resolutions, assets acquired and sold, enforcement efforts, costs incurred, affordable housing, minority outreach, and management issues. Finally, we look ahead to consider the question of resources.

Before we do so, we should face squarely the fact that the real estate market in a number of areas in the U.S. is in a weakened state and has become particularly so in the last year. This affects every aspect of the problem we face, especially the job of estimating the size of the problem. The condition of the real estate market affects the number of institutions which fail, the value of their assets, the speed at which assets can be sold, and thus, the ultimate loss.

FIRREA requires that we estimate the remaining exposure of the U.S. government from institutions which will come under the control of the RTC. We have attempted to do so in this statement, but note that such estimates are highly uncertain because they require market predictions, which are themselves highly uncertain. For that reason, no one should assume that the estimates presented today will not change. They will.

A LOOK BACK

The problems we are wrestling with today have roots which reach back over many years. They extend back to events of more than a decade, as the thrift industry struggled to cope with economic adversity and fundamental changes in financial markets; to broadened powers, coupled with insufficient policing by government regulators; to capital requirements which resulted in too little of thrift owners' money being at risk; to problems in real estate and the junk bond markets; and, in many instances, to mismanagement and misdeeds. Many of these problems flow together and feed on one another.

The savings and loan problem was there to greet President Bush when he took office in January 1989 and he wasted no time in responding. Less than a month after taking the oath of office, the President came forward with a plan and made it one of his highest priorities to enact it into law.

You in the Congress and we in the Administration worked together last year as architects of a plan to repair the damage and reform the system. Together we devised a plan to resolve the savings and loan crisis and to help prevent it from happening again. While comparisons with other government rescues are inevitable, this is not a bailout. We are not bailing out shareholders. We are not bailing out management. We are not in this to preserve institutions. In fact, many will be lost. It bears repeating that monies spent are to protect depositors.

It was just over a year ago that Congress took up consideration of FIRREA, under your leadership, Mr. Chairman, and that of your Committee. The Banking Committee marked up the Administration's bill in record time, preserving the essence of the plan but adding its imprint. For example, reforms were put forward in matters such as capital requirements; the creation of the Federal Housing Finance Board; the membership of the FDIC and Oversight Board; the tightening of the qualified thrift lender test; provisions to avoid asset "dumping"; restrictions on the activities of state-chartered thrifts; limits on loans to one borrower; and curtailing "junk" bond investment.

With the enactment of FIRREA on August 9, 1989, the machinery was put in place.

A PROGRESS REPORT

Under the provisions of FIRREA, the Oversight Board must report on case resolutions, costs incurred, and asset sales during the period from October 1, 1989 through March 31, 1990, along with providing certain other financial information. While reporting on the six-month period as required, we have not limited ourselves to that and, where possible, provide in this statement information on more recent RTC activities.

As we review the progress to date, it is important to remember that a key purpose of FIRREA is to provide the money and mechanisms to separate out insolvent and failing thrifts, so that the industry which remains can compete successfully and safely in the financial marketplace.

The evidence is that FIRREA is working. Based on fourth quarter 1989 figures, OTS has analyzed the thrifts which remain after removing the institutions already resolved, those currently at the RTC for resolution, and those likely to be sent to the RTC in the near future. The industry which remains is profitable, has on average more than three percent tangible capital, and is growing by adding deposits.

Case resolutions

When the RTC started its work on August 9, 1989 there were 262 institutions in conservatorship. Since August, the RTC has resolved 93 cases (including 28 between October 1 and March 31), while adding 161 institutions to the caseload. That left the RTC, as of May 14, 1990, in control of 330 conservatorships.

There has been discussion about the RTC's relatively slow start in case resolutions. We believe it is important to try to understand why it has taken longer to resolve institutions than some may have initially expected or hoped.

First, let us make clear that it has not been for lack of resources. Immediately after FIRREA was signed, $20 billion was provided to the RTC in appropriated funds and industry contributions. The Resolution Funding Corporation has provided $13 billion. The Oversight Board acted in February to allow the RTC to borrow working capital from the Federal Financing Bank. The availability of those resources has ensured that no disruption has occurred for lack of resources.

One factor that certainly affected the pace of resolutions during the first several months is that it takes time to build an organization, particularly one so large and with so difficult a task as the RTC. Given the magnitude and the complexity of the task and the need to make sure the process serves the public interest, there has been a need to establish policies and procedures. The Oversight Board and the RTC Board have attempted to guide the process in a way that is consistent with the law, serves the interest of the taxpayers, and tries to avoid repeating mistakes. The staffs of both organizations have labored mightily to establish systems, methods, and order.

Yet it takes time to put people in place, to establish operating procedures and to make sure they are working out in the field; to learn their way around the problem; and to work out snags. I am surprised by those who so readily dismiss the difficulties of creating in just nine months an organization that is roughly the size of Citicorp.

But the major problem faced by the RTC in trying to resolve cases is that there simply have not been many interested buyers for the assets taken over, especially for whole thrifts.

We are concerned about the effect of the conservatorship program -- in essence, the government warehousing of private sector assets -- on franchise values. In presenting the idea of RTC's new accelerated resolution program, Chairman Seidman referred to the deterioration in value of institutions which remain under the control of the government for a prolonged period and made the case for early intervention. We support this goal -- that is, to deal with an institution when resolution costs the least -- but continue to focus on the need to resolve the existing conservatorship caseload.

RTC's concern about a pile-up of retained assets of failed thrifts seems to have been another factor affecting the pace of resolutions. The RTC rightfully recognizes the difficulty of managing and disposing of assets and will therefore attempt to pass as many assets as possible to private sector acquirers. We certainly share that as a goal, but tend to support the quicker pace of resolutions, while moving on a separate track to return the assets quickly to the private sector.

We have encouraged the RTC over the past several months to place greater reliance on liquidations (including deposit transfers) as a method of resolution. The RTC's third quarter plan reflects such a shift in emphasis.

One action requested by the RTC and taken by the Oversight Board may help speed resolutions. In February, the Board approved a policy establishing a general limit of twelve months on the amount of time that an acquirer has to decide to put assets back to the RTC. This policy will give acquirers adequate time to get to review the assets of an institution without a lengthy period of review preceding the acquisition. The hope is that this will not only quicken the pace but also increase the likelihood that acquirers will take on assets.

With policies in place and the lessons of nearly eight months of operations, the RTC in March laid out an ambitious schedule of case resolutions for the third quarter of fiscal year 1990. The plan calls for resolving 141 institutions with assets totalling nearly $50 billion between April 1 and June 30, 1990.

The Oversight Board endorsed the third quarter plan and approved the funds necessary to carry it out. The plan approved by the Oversight Board provides for up to $51.6 billion in spending on case resolutions during the quarter, of which $19.1 billion represents estimated net losses and $32.5 billion the recovery value of receivership assets.

We recognize that the RTC has set a challenging goal for itself in the third quarter plan and we will continue to provide the support needed to allow the maximum possible success.

Assets acquired and sold

There are two groups of assets under the control of the RTC: those in conservatorship and those in receivership. As of March 31, 1990, there were 350 institutions in conservatorship with gross assets, in book value, of $159.9 billion (based on December 31, 1989 financial data). The composition of assets held at that time was as follows:

Table 1

CONSERVATORSHIP ASSETS
350 Conservatorships as of March 31, 1990
Book Value of Gross Assets

($ billions)

Cash and securities	$41.6	26%
Mortgages	$80.4	50%
Other loans	$13.5	8%
Real estate owned	$13.8	9%
Other assets	$10.6	7%
Total	$159.9	100%

The composition of assets under the control of RTC receiverships as of March 31, 1990 was as follows:

Table 2

RECEIVERSHIP ASSETS
52 Receiverships as of March 31, 1990
Book Value of Gross Assets

($ billions)

Cash and securities	$ 1.7	13%
Mortgages	$ 7.1	53%
Other loans	$ 0.9	7%
Real estate owned	$ 2.9	22%
Other assets	$ 0.7	5%
Total	$13.3	100%

The largest part of the RTC's asset disposition efforts has been sales from conservatorships. This follows from the guidance provided by the Oversight Board in the Strategic Plan, which provides "to the extent feasible and cost effective, the asset side of the balance sheet [of thrifts in conservatorship] should be reduced through the packaging or securitization and sale of financial assets."

While the RTC has compiled a substantial record on sales from conservatorships, there has been less progress in disposing of receivership assets. To some extent, this is understandable, because the receivership assets are the most troubled. The Oversight Board and the RTC, however, are anxious to establish a record of steady and solid progress in the sale of assets.

Table 3 shows the level of sales and other collections on assets held or managed by the RTC through March 31, 1990. It shows that, through March 31, 1990, the RTC has reduced the volume of assets under its control -- including both conservatorships and receiverships -- by $41.9 billion through March 31, 1990. We recognize that the most marketable assets are sold first, but we are nonetheless pleased to see this level of reduction.

Of the $173.2 billion in assets under the control of the RTC at the end of March (both in conservatorships and receiverships), $16.7 billion or ten percent was owned real estate. It is too early in the process to assess the impact of RTC real estate sales on local markets.

It becomes critically important to achieve greater progress in the area of asset sales as the number of resolutions increases. At the end of the second quarter of the fiscal year, the estimated fair market value of receivership assets totalled about $7 billion. Under the third quarter operating plan, that total could increase as high as $39.5 billion.

We must take advantage of the opportunity to dispose quickly of assets which have a ready market, such as single-family mortgages. If reasonable representations and warranties are required, as are customary in the marketplace, we would support the RTC in giving them.

We also support the RTC in the procedures recently adopted for determining the market value of assets and establishing prices for sales by auction. We believe that the RTC Board has taken an initial step toward dealing with appraised values which may in some cases overstate market values and so communicated that to the RTC during its deliberations. We find the approach which they have taken to be responsible.

Table 3

Balances of Assets Held or Managed by RTC from Inception through March 31, 1990
402 Institutions *

($ in billions)

		Reductions during Conservatorship			Resolution & Receivership Reductions			
Asset Type	Beginning Conserva-torship	Sales Proceeds	Payments & Matur-ities	Other Changes (Net) **	Passed to Acquirer	Principal Collect-ions	Other Changes (Net)	Balance at March 31, 1990
Mortgages	102.8	-2.3	-7.2	-1.8	-3.8	-0.2	0.0	87.5
Other Loans	17.1	-0.4	-2.3	0.7	-0.9	-0.1	0.2	14.4
Cash & Secur.	60.9	-14.8	-6.0	3.2	-1.0	-0.1	1.1	43.3 ***
Owned Assets	16.3	-1.8	-0.1	2.4	-0.0	-0.1	-0.0	16.7
Other Assets	17.7	-0.6	-0.3	-4.9	-0.6	-0.0	-0.0	11.3
TOTALS	214.9	-19.9	-16.0	-0.3	-6.3	-0.5	1.3	173.2

* At March 31: 350 Conservatorships
52 Receiverships

** Changes in Other Assets include charge-offs of certain intangible assets and equity investments

*** Includes approximately $1.1 billion in receivership cash available for the payment of expenses and dividends.

Just two days ago, the members of the Oversight Board met with Chairman Seidman to discuss ways to expedite asset disposition.

Enforcement efforts

We must vigorously pursue those whose criminal and fraudulent activities helped create the current situation. As we observe the failed institutions and contemplate the mounting losses, we continue to be convinced that the government must provide the resources that are needed to make certain that those who have abused insured institutions know the effects of justice.

The RTC has established an Office of Investigations in Washington and has teams of investigators throughout the country. The RTC's investigations staff is planned to reach 300 by year end. These investigators will help to identify negligent and reckless mismanagement, fraud, and criminal conduct that contributed to thrift insolvencies. The RTC's investigators will be involved throughout civil litigation proceedings and also will assist the FBI and the U.S. Attorneys in criminal prosecutions.

Thrift regulators and institutions have made over 17,000 criminal referrals in the last three years. Over the same period, OTS and its predecessors required 664 institutions to enter into binding agreements terminating unsafe and unsound practices; removed over 150 senior officers and directors from thrifts and forbade them ever again to be employed by an insured thrift institution; and issued 111 cease and desist orders, to stop unsafe and unsound practices and to require restitution. In addition, there are over 1,000 civil law suits seeking to recover billions of dollars from the former directors, officers and professionals -- including accountants and lawyers.

Criminal referrals have already resulted in prosecutions and convictions. The Woody Lemons case in Dallas, Texas provides a dramatic recent example. Lemons, the former Chairman and Chief Executive Officer of Vernon Savings and Loan in Vernon, Texas, was sentenced to spend 30 years in prison, following his conviction for an elaborate bank fraud scheme, misapplication of Vernon's funds, and bank bribery.

As of May 11, 1990, the Dallas Bank Fraud Task Force, in which OTS and RTC personnel are working closely with the Department of Justice, has charged 70 defendants and obtained 49 convictions. That Task Force also has succeeded in having the courts impose criminal restitution orders of over $16 million.

Despite the extent of our present enforcement activities, the government needs to do more. To accomplish this goal, the Attorney General and I are working to see that financial misconduct is punished. We are establishing priorities for the major criminal referrals and civil cases of all financial regulatory agencies and are working with the Department of Justice to see that the most important criminal cases receive the priority attention they deserve.

Affordable housing

Since we last appeared before the Committee, the RTC has proposed and the Oversight Board has approved an interim rule for the Affordable Housing Disposition Program. This is the rule which implements the provisions of FIRREA requiring the RTC to offer certain residential properties to qualified purchasers for a 90-day marketing period. The interim rule was published in the Federal Register on April 16, 1990 and comments must be submitted by June 15.

The development of this rule was a collaborative process between RTC and Oversight Board, as has been the development of an interim rule for the disposition of properties having no reasonable recovery value. The guidelines will provide for the conveyance of properties from which the RTC expects no reasonable recovery, for purposes such as housing for lower income families, homeless shelters, and day care centers.

In March, the Oversight Board approved a policy encouraging the RTC to enter into agreements with state and local housing finance agencies to provide financing for RTC affordable housing properties. These programs use tax-exempt financing to make mortgages at below-market interest rates. The Oversight Board has authorized the RTC to spend up to $6 million during the balance of fiscal year 1990 to pay reasonable and customary commitment fees, thereby reserving funds for RTC properties.

The first use of this program will be in Texas, where the state housing agency will issue $140 million in bonds to fund approximately 3,000 homes at an expected interest rate of about 8.5 percent. Negotiations are under way for similar programs in four or five other states.

The Strategic Plan did not provide for the use of direct subsidies, such as price discounts and concessionary financing, in the marketing of its affordable housing inventory. The goal was to test the right-of-first-refusal period, with the RTC to report to the Oversight Board by May 30 on the results of this pilot program. We believe that the 90-day marketing period and arrangements such as that entered into with the Texas Housing Agency will help in meeting FIRREA's affordable housing goals.

Minority outreach

The minority outreach efforts of the RTC fall into two major categories: outreach to minority and women contractors and preservation of minority- and women-owned institutions.

The RTC has developed policies and procedures implementing both the three percent price advantage for minority contractors, provided for in the Strategic Plan, and a preference point system. Thus far, the RTC has concentrated much of its energy on getting eligible minority contractors registered. To date, some 20 percent of contractors registered are minorities and women.

The second major area of outreach attempts to facilitate the continuation of minority institutions, as directed by FIRREA. The Oversight Board has authorized the RTC to postpone closing a transaction for up to nine months or provide bridge financing for the same duration in order to assist minorities acquiring minority institutions.

The Oversight Board will supplement these efforts through a program of information and outreach to minority- and women-based organizations. On a quarterly basis a list will be provided of all institutions in conservatorship, identifying those which are minority-owned.

FUTURE REQUIREMENTS

Since the thrift crisis first emerged, there have been a number of sources providing explanations and estimates of the size of the problem. Each has a projection as to how many thrifts will require government expenditures and how much the entire cleanup will cost.

Some give cost estimates on a present value basis while others give them on a cash basis. Some estimate total costs for resolving the thrift crisis, while others focus on additional funds required.

Estimates also vary on whether they include REFCORP interest costs, interest on working capital, and even the effect on government borrowing costs. Including interest costs treats the savings and loan program differently from other government programs and has the effect of dramatically increasing cost estimates.

In short, there are a myriad of estimates prepared using a variety of methods. Of course, the highest estimates get the most attention. Let me give you our view of where things stand.

FIRREA established a funding structure which has three parts. First, it provided for the payment of prior commitments of FSLIC from the old FSLIC fund, anticipated insurance premiums from SAIF members, other revenues received by FSLIC, and, as a last resort, Treasury funds. At the time FIRREA was signed into law, it was estimated that the cost of winding down FSLIC, in present value terms, would be about $40 billion. Given market conditions, it now appears that the cost will be higher than originally estimated.

FIRREA requires the RTC to review all of FSLIC's 1988 assisted thrift acquisitions and report to Congress and the Oversight Board. Under the Strategic Plan, the report is to be completed by August 31, 1990. At that time, we will be better able to evaluate the long-term cost of these cases and to pursue modifications where savings would accrue.

Second, FIRREA provided $50 billion ($18.2 billion in appropriations, $1.2 billion from the Federal Home Loan Banks, and $30 billion from REFCORP) to resolve the RTC caseload -- that is, insolvent savings and loans which fail during the three years subsequent to the enactment of FIRREA.

At the time FIRREA was enacted, there were approximately 350 insolvent thrifts with assets of about $170 billion and roughly another 150 institutions with $100 billion in assets that would almost certainly become insolvent in the near term. The $50 billion requested was based on the most credible estimates at the time, prepared by the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board, and the General Accounting Office.

Finally, FIRREA established the Savings Association Insurance Fund (SAIF) to bear the cost of thrift failures which occur after August 9, 1992. Though we did not have a firm estimate of the funds that would be required by SAIF to meet its obligations, FIRREA authorized the Treasury to provide up to another $32 billion for this purpose. The present value of these future commitments is $23 billion.

At the time of the legislation, there was a great deal of uncertainty about the long-term cost of fixing the problem. The Administration stated repeatedly in letters and testimony that we could not say precisely which or how many institutions would fail, the nature and quality of their assets, what it would take to resolve them, how the performance of the economy and the real estate market would affect costs, or where interest rates would be -- all key variables in estimating the cost. Those same difficulties exist today.

To further illustrate this point, let me quote from a letter which I sent to Chairman Riegle, dated June 23, 1989, in response to his question about the adequacy of funds to be provided in

FIRREA:

> "Let me emphasize ... that this level of resources, no matter how thoroughly researched or widely agreed upon, is still based only on estimates. Uncertainties include the level of interest rates, the strength of the economy, as well as many other factors that could have a significant impact on the size of the problem. As a result, the actual cost of case resolutions could be higher or lower, depending on the actual circumstances."

As of May 14, there have been a total of 423 thrifts with $215 billion in assets placed in conservatorship. The RTC has resolved 93 cases for which the estimated loss totals about $11.5 billion. In other words, the RTC has incurred losses equal to about 23 percent of the $50 billion provided in FIRREA.

If the RTC were to resolve all 141 institutions planned for the third quarter of fiscal year 1990, estimated losses would accumulate to $28.3 billion by June 30. At that point, there would be 189 institutions left in conservatorship, plus additional thrifts which come under the RTC's control.

When we appeared before you in January, we stated "when we became convinced that additional resources are necessary to continue the program, we will request them in a timely manner." It is now clear that the amounts projected and authorized for the RTC in FIRREA will fall short of what is required.

The causes of these increased RTC losses appear to fall in three different categories: the losses in individual thrifts are larger than expected; marginal thrifts are likely to fail sooner than expected (becoming the responsibility of the RTC, not SAIF); and the total number of projected thrift failures has increased.

Why has this happened? We believe the answer lies in a combination of the factors causing uncertainty. The fact is that we now have what we simply could not have had at the time FIRREA was considered and enacted -- actual experience with the cost of marketing insolvent thrifts and their assets. This experience with 93 resolutions has made us more pessimistic about losses embedded in thrifts both inside and outside the RTC's current caseload.

A number of factors have contributed to these higher projections, including ones with which this Committee is very familiar. The first is a general decline in regional real estate markets, particularly commercial real estate. This has been true not only in the southwest, but in the northeast, southeast, and other parts of the country. Unfortunately, thrift assets are heavily concentrated in real estate, whether through direct investments, foreclosed property, or real estate loans. FIRREA sharply curtailed the amount of commercial real estate activities that thrifts can engage in going forward, but obviously, it could not address the losses already embedded in troubled thrifts.

A related concern involves the institutions that we expected would be the primary purchasers of thrift deposits and thrift assets -- other depository institutions. It's no secret that healthy banks and thrifts have become much more leery about taking real estate assets onto their balance sheets in view of current market conditions. Unfortunately, that is exactly what the RTC is trying to sell to them. The result has been few "whole thrift" transactions, where both good and bad assets pass to an acquirer, and few transactions where the acquirer takes any bad assets. This means more bad assets piling up at the RTC with lower expectations of the ultimate revenues they will produce.

A third factor is interest rates, which are now higher than we had projected. That translates directly into increased operating losses for thrifts in conservatorships and indirectly into softer real estate markets, since interest rates always play a key role in that sector of the economy.

A fourth factor is unexpected losses in below-investment grade bonds, sometimes referred to as "high yield" or "junk" bonds. As you know, FIRREA required thrifts both to divest these bonds and to carry them on their books at market value. The market for these bonds has dropped off substantially in recent months, and virtually all of the major thrift holders of these bonds have been taken over by the RTC. The result is that the RTC is now one of the largest owners of junk bonds, with some $4 billion in its portfolio, and it could end up with substantially more. At the same time, we just don't know exactly how much these bonds will be worth when they are finally sold.

A fifth factor is that, at least for some purchasers, thrifts just are not as attractive a franchise relative to banks as they once were. This is true in part because it is no longer possible either to run a thrift with low capital or to invest insured deposits in risky activities like direct real estate investment. That is as it should be, since it was activities like these that helped cause the problem.

But other restrictions imposed by FIRREA that are unrelated to safety and soundness, like the tighter qualified thrift lender test, may have also reduced the value of the thrift charter. However, it is too soon to say by how much.

Again, all of these factors have produced not only higher than expected losses, but also an increase in the population of savings and loans that will require attention. To some extent, this results from the fact that cases which we expected to be handled in the future by SAIF -- and for which FIRREA provided

$32 billion -- will in fact be handled by the RTC. These cases are merely moving forward in time.

When will more funding be needed? Even though the RTC has committed less than a quarter of the $50 billion, it could, with an aggressive schedule of case resolutions, run out of funds by the end of this calendar year or early next year. If progress occurs at a slower pace than we would hope, RTC resources will last longer.

Of course it would be possible to slow the pace on the hope that market conditions will improve in the future. We believe that there has been too much speculation already. Our job is to be steady, do the work, and take no further gambles with the taxpayers' money.

How much more will be needed? As we have discussed, there are too many variables to pin a single number on it -- again, number of cases, losses on assets, interest rates, and market conditions, to name a few. The most responsible course, we believe, is to consider a range of possible outcomes.

The Office of Thrift Supervision has indicated that there are some 299 institutions with assets totalling $193 billion -- over and above the 423 that are or have been in conservatorship -- which are likely candidates for transfer to the RTC. We cannot say for sure, however, whether all of these institutions will come under the RTC's control.

There are another 315 thrifts with $152 billion in assets for which the future is uncertain but which currently have positive tangible net worth and do not require assistance. We simply do not know which and how many of these institutions will come to the RTC and what condition they will be in when they get there.

In short, at this point in time, the number of institutions which the RTC will have to resolve is simply unknowable. Yet this number drives the cost estimate.

Another source of uncertainty is the level of loss incurred by the RTC on institutions which come under its control. Losses in turn depend on a variety of factors which are difficult to predict. What will be the condition of institutions taken over by the RTC? How many will be resolved on a whole thrift basis and how many clean?

The more liquidations and clean thrift resolutions that the RTC does, the more assets it must sell and the more uncertainty there is about losses. The discount which the market places on assets will vary by category. For example, performing mortgage loans generally can be sold for a higher percentage of their book value than can owned real estate. In the end, the loss rate on assets will depend on unpredictable factors such as market conditions, including the state of the real estate market, and interest rates.

This is clearly a formidable list of factors, each of which can substantially affect the total cost of resolving the RTC's caseload of institutions. For example, a reasonable lower limit on the number of institutions which will have to be resolved, together with small, medium, and high levels of losses on selling the assets of these thrifts, produce cost estimates (in present value terms) of $89 billion, $97 billion, and $114 billion.

For reference, the estimates in this statement should be compared with $73 billion provided in FIRREA. In other words, they include the $50 billion provided for the 1989-92 period and the $23 billion (in present value terms) provided for the succeeding eight years.

The same loss factors applied to a reasonable upper limit on the number of institutions to be resolved yields cost estimates (in present value terms) of $99 billion, $113 billion, and $132 billion. Again, these figures should be compared with amounts already provided by FIRREA, not added to them.

Of course, one could make even bleaker assumptions and make an estimate based on even higher populations of failed thrifts and even higher loss factors. This would dramatically increase the top range of the cost estimate. While such an scenario is theoretically possible, we believe it to be quite unlikely under any reasonable set of economic conditions.

As has become the convention, all of these estimates are given in present value terms. Presenting estimates in constant dollars allows us to compare better, but admittedly does also produce a lower total than nominal dollar estimates.

Any attempt to convert these aggregate 1990 dollar costs to yearly expenditures must incorporate an additional factor, the pace at which the RTC can resolve institutions. This greatly affects the amount of loss which the RTC must absorb on a yearly basis. A representative range of the resources the RTC may need in fiscal year 1991 would be $34 billion to $54 billion, excluding working capital. FIRREA already provides some of these resources to fund losses through REFCORP.

The other major source of uncertainty in measuring the yearly effect of RTC spending is of course working capital. We have provided the RTC access to working capital through the Federal Financing Bank. When the RTC uses these borrowed funds to acquire assets, it counts in the budget as an outlay; when assets are sold, it counts as a receipt. Thus RTC's short-term borrowing requirements will result in enormous budgetary swings and distort the true picture of the deficit.

All of this suggests that there are too many unknowns to provide a single estimate of the ultimate cost. Taking into account all of the uncertainty and all of the variables, it appears that the cost of resolving institutions which are likely to come under the control of the RTC will be in the approximate range of $90 billion to $130 billion. Once again, these figures are in present value terms and include the $73 billion provided in FIRREA ($50 billion for 1989-92 and $23 billion for future SAIF cases).

How should additional funds be raised? The Federal Home Loan Bank system simply does not have the capacity to back substantially more Resolution Funding Corporation (REFCORP) borrowing. Additional resources will have to come from the Treasury funds.

Finally, how should the funds be provided? There appear to be two basic choices: either provide a specified amount to cover some or all remaining losses or provide the RTC such sums as are necessary to complete the job. No matter how the funds are provided, it will not change the cost of resolving the savings and loan crisis. This is not a discretionary activity; the government's deposit guarantees must be fulfilled.

There is precedent in the federal budget for providing indefinite authority to fund mandatory activities. Congress can choose to provide resources to the RTC in increments, but that means having to face the prospect of returning at relatively short intervals as markets changes and, along with them, the estimates.

The RTC faces another important constraint in the form of FIRREA's obligation limitation. This is the provision which limits obligations -- most notably, working capital borrowings -- to the amount of unused REFCORP authority, cash on hand, and 85 percent of the fair market value of assets held by the Corporation.

The RTC is likely to run up against the obligation limit as soon as or even sooner than it reaches $50 billion in losses. If the RTC cannot raise additional working capital and the cost of acquiring assets exceeds the amount generated from sales, it cannot proceed with resolutions.

The Oversight Board intends to work with the Congress and the Administration to develop an approach which will provide the RTC the resources necessary to finish the job, while maintaining adequate controls. Given the enormous significance of this issue for the federal budget, we believe that this is a matter which should be considered in the current budget discussions between the Administration and the Congressional leadership.

In closing, we would echo a view expressed recently by Chairman Seidman. This is a long, hard job and it will take an extended period of time to finish it. However, we stand behind the commitment made by President Bush in his first weeks in office: protect depositors; clean up the industry at the least cost to the taxpayers; and punish the criminals.

APPENDIX

Among the requirements established in FIRREA for this appearance, Oversight Board must:

-- "provide an estimate of the short-term and long-term cost to the United States Government of obligations issued or incurred during such period;" and

-- "describe the costs incurred by the Corporation in issuing obligations, managing and selling assets acquired by the Corporation."

As of March 31, the RTC had issued about $2.5 billion in obligations in the form of short-term working capital borrowings from the Federal Financing Bank. No significant costs were incurred in connection with the issuance of these obligations. As required by FIRREA, these borrowings are backed by assets having an estimated fair market value substantially in excess of $2.5 Billion, in order to comply with the 85 percent test. Based on current projections of market value, we expect that the U.S. Government ultimately will not incur any cost in connection with these short-term obligations.

At the present time, virtually all of the assets under the RTC's control are managed either by institutions in conservatorship or, with respect to receivership assets, by acquirers pursuant to short-term contracts. Thus, for the reporting period, the costs of managing and selling RTC assets has been borne at the conservatorship and receivership level, and about $30 million was paid to private contractors for this purpose. It should be noted, however, that the RTC's operating plan for the third quarter of fiscal year 1990 contemplates an expenditure of $70 million for payment of fees to asset management contractors, reflecting the anticipated widespread use of asset management agreements.

The **Chairman**. Thank you, Secretary Brady.

Now we have had four other Senators join us, and I am going to call on them just very briefly for any opening comment they want to make before we begin the questioning.

Senator Shelby.

Senator **Shelby**. Mr. Chairman, I have an opening statement, and I ask unanimous consent that it be made part of the record, and I'll leave my turn with the participants.

The **Chairman**. Very good.

STATEMENT BY SENATOR RICHARD SHELBY

Senator **Shelby**. Mr. Chairman, this morning's hearing is to focus on the progress of the Resolution Trust Corporation and its handling of the clean-up of the savings and loan crisis.

I believe that there is a consensus that the progress thus far has been disappointingly slow. While not one of this committee would underestimate the magnitude of the task ahead of the RTC nor would one of us, after working on FIRREA last year, fail to appreciate the complexities of the task, I believe that each of us would like to see the tourniquet tying off the hemorraghing red ink, twisted tighter and faster.

It was the consensus of Congress and the administration that the task was to be done right. The clean-up of this scandal afforded an even greater opportunity for fraud, abuse and scandal than any of the individual institution's failure and for this reason, it was essential to put in place sufficient checks and balances.

However, in accomplishing that objective, I am concerned that we have perhaps created a structure with the decisionmaking process so dispersed that we have built in inefficiency and redundancy. If that is the case, we should change it. All of the members of the Oversight Board are busy men with important jobs; they would be unlikely to perpetuate an unnecessary bureaucracy. I would like to pursue this in my questioning.

I am also concerned with the pace of the asset disposition process. There again I am concerned that we may have built in so many checks to prevent against dumping and to prevent any more embarassing situations like the 1988 year end deals, where acquirors got richer as a result of Government breaks, that we have hamstrung the process. If there is no opportunity for a profit, there is no buyer. RTC asset disposition policy has to emphasize speed in its evaluation of prospective purchasers and their offers in order to maintain buyer interest. Let's get these properties back into private hands as quickly as possible.

Finally, I am concerned over the lack of interest from prospective acquirors in the thrifts themselves. It is my understanding that the bulk of the institutions sold have been relatively small ones, under than $100 million in assets. What can we do to make these large institutions, often disproportionately bigger problems, more attractive to investors?

It is the nature of the oversight function to second-guess, to cross-examine and perhaps to criticize. That does not mean that we are not cognizant of the burdens of your task. I sincerely hope, however, that where there are problems in FIRREA, you will help us identify them and where you need assistance you will ask for it. In my view this is not a political hot potato but a continuously ticking time bomb that has been dropped on the taxpayer. It remains the responsibility of this committee, Congress and the administration to defuse it.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator D'Amato.

Senator D'AMATO. I will ask the same, that my statement be included in the record as if read in its entirety.

The CHAIRMAN. Very good.

STATEMENT OF SENATOR D'AMATO

Senator D'AMATO. Mr. Chairman, I join you in welcoming our distinguished panel of witnesses and I would like to make a couple of observations.

First, we have always known that selling the assets of defunct thrifts would be different. We have also known that the majority of those assets were real estate, and that the real estate was located in areas where there was little demand for it. And we may have even thought that, unlike other thrifts assets, real estate does not travel too well. We worried about "dumping" and we worried about "overhang" and we worried most about people buying that real estate and making a killing at the Government's expense. Mr. Chairman, I think it is time to stop worrying because that may be the only way to unload this stuff.

By now everyone in the real estate business knows that the RTC is the Government. As with any other bankruptcy, the fact of Government sale and bankruptcy by itself makes the market demand a bargain price before it will buy. We should accept this fact and make the best of a bad situation. Real estate cannot travel to where the money is but money will flow like water down a hill to a bargain.

The RTC's plans to try some new marketing and sales strategies is a step in the right direction. Bulk sales to get the "for sale by the Government" tag off these properties should also be considered.

In a similar vein I am pleased to see that the FDIC/RTC real estate project is attempting to develop some early warning inducators of overheated real estate markets. Clearly, the risky nature of excessive development in a slack real estate market is one lesson we have learned from the S&L mess.

I hope that we will learn some lessons, expensive lessons, from the RTC experience and help to avoid another banking debacle.

The CHAIRMAN. Senator Sarbanes.

OPENING STATEMENT OF SENATOR SARBANES

Senator SARBANES. Well, Mr. Chairman, first let me say I am very pleased to see Mr. Larson and Mr. Jackson at the table. The last time we had an oversight hearing there, unfortunately, were two empty seats, and that caused it considerable concern, additional concern on the part of the committee as it had already because of the failure to fill those places.

So, gentleman, I don't envy you your responsibilities, but we are pleased to have you in place, although it's a long time in the coming.

Mr. Chairman, I don't want to add yet another problem, but I see we've got Mr. Greenspan and Mr. Brady here, and Mr. Taylor, who is rumored to be going on to other things, and I'm concerned about this additional problem which now seems to be emerging at a rather rapid pace, and that is one of the lead stories in the morning papers that the assets of the Federal Deposit Insurance Corporation fell last year to their lowest levels as a percent of insured deposits since the fund was established in the 1930's. Apparently it's down to 70 cents in assets for every $100 of insured deposits at commercial banks. That is a drop from 80 cents the year before, and the general SAIF figure is figured to be a $1.25. Now I know this is separate and apart from the savings and loan issue, but it does raise the very serious concern as to whether we are facing potentially comparable problems in that field, and I hope at some point this morning that perhaps Mr. Brady or Mr. Greenspan can address that concern.

Should we now be on the alert for some kind of repeat experience with respect to the commercial banks and the FDIC?

Thank you very much.

The CHAIRMAN. Thank you, Senator Sarbanes.

Senator Kassebaum has joined us as well.

Do you have opening comments?

Senator KASSEBAUM. No, I will wait until later.

The CHAIRMAN. Secretary Brady, we have worked closely with you to develop this legislation, and we want to continue in that same spirit as we move forward here.

There are two things that I would like to pin down in the first round of questioning in terms of the time that I have, and one is these estimates on cost which, as you point out, are hard to be specific about.

You made a reference to letters that you and I exchanged last year just prior to getting the legislation enacted, and there, as you know, was some concern then that we might be looking at costs that would be substantially higher. We provided the amount of money that the administration asked for at the time, and I want to be clear as to within these range of estimates exactly what the current reading is in terms of additional monies needed. So let me tell you what I am inferring from what has been said, and you tell me if I am interpreting this properly.

I gather that the testimony that you are giving today says that the cost from here on out of additional closures and failures in the thrift industry is going to be somewhere between $89 billion on one end of the range based on the different assumptions up to a high of $132 billion. If that is right and I am interpreting that correctly if you take from that the $50 billion that we originally provided in the legislation, it would look as if what you are asking for or suggesting is likely to be needed here is another $39 billion at a minimum on top of the original $50 billion up to a high figure of as much as perhaps $82 billion over the original $50 billion that we provided.

Now all of this leaves aside the working capital question. That is a different story, but just in terms of your best estimates today of losses that are going to occur and have to be covered, am I interpreting that data properly?

Secretary Brady. Let me see if I can state it, and then we can compare it, Mr. Chairman, with what you have said.

Our estimate of the amount of money that will be required is in a range of $89 billion to $132 billion. In our opinion, that is not additional funds. That is funds from which we would subtract the $50 billion FIRREA provided for RTC and the $32 billion provided for SAIF. The SAIF funds in present value terms would be $23 billion. So that we say that you ought to subtract from the $89 billion and the $132 billion the $73 billion that those two figures add to.

The Chairman. Now the money from the SAIF Fund, the $32 billion that you're also counting, would you also just clarify that a little bit.

Secretary Brady. Yes. For after August 9, 1992, when RTC expires, some $32 billion were budgeted, at the time of the enactment of the legislation, for use by SAIF. SAIF is the fund which is being created for the resolution of the S&L problems after August 1992.

In order not to overstate the figure, we bring that figure, as we have with all of them, back to today's values and say that the $50 billion plus the $23 billion is $73 billion. So at the time of legislation we provided the $50 billion plus the $23 billion and you should compare that, in our view, to our range of $89 billion to $132 billion.

The Chairman. Well, trying to make these numbers understandable is not easy under the best of circumstances, but I guess I would be concerned as to whether or not the SAIF estimates are still solid. In other words, this projection of money coming in the future, some of it I know has to stay in the fund as a part of the insurance base in the fund, as I understand it.

But if you take that out, if you stay with your original assumption on the buildup in the SAIF Fund and take that out of the $32 billion and then discount the remainder to the present value to cover part of the losses, what does that leave us with? In other words, take that out, and how much more than the $50 billion do we now anticipate, or at least the range of the net losses that are going to have to be covered here?

Secretary Brady. Well, if you do it your way, it's $89 billion less $50 billion, and $132 billion less $50 billion. If you do it our way and include the $73 billion, then it's $89 billion less $73 billion, which is $16 billion, and $73 billion from $132 billion is $59 billion. That does not include, as I understand it, budgeted funds of some $7 billion in the current baseline. In one case it's $49 billion to—let's see—$89 billion less $50 billion is $39 billion, and $132 billion less $50 billion is $82 billion according to your figures and according to our $73 billion.

The Chairman. Well, every member will have to take a look at this for themselves because these numbers are inherently confusing. I guess the bottom line is we are likely looking at some multiple of $10 billion above the $50 billion. I mean regardless of which counting and adding and subtracting system, we are looking at losses that are substantially higher than were anticipated before.

Let me just ask one other question with respect to the number of institutions and tell me if this squares with the data that you folks have. The data that we have would indicate that since 1987 up to the present time that there have been 360 thrifts that have failed and have been sold off by the regulators.

In addition to that, the RTC has a caseload of another 300 that have failed and that are awaiting resolution. Then the OTS has identified 299 that will likely fail, and another 315 that are in danger of failing.

So if you start to add these categories up, as nearly as we can determine, it appears that we have had 660 that have in effect failed in the last 3 years, and that there are another 614 out in front of us that may very well fail over the next 2 years. Now hopefully not all will.

Now are those numbers the ones that would be comparable to what you are working with? In other words, it would lead me to the conclusion that we are going to see probably at least a 1,000 individual institutions go down based on those that have already failed, the 660 according to our data, and some reasonably high percentage of the 614 that are out there that are anticipated to be in very tough shape.

Is this more or less an accurate sizing of the number of institutions?

Mr. Taylor, did you want to respond?

Mr. TAYLOR. Yes, Senator. If you take from the date that FIRREA was enacted into law——

The CHAIRMAN. I'm backing up from that.

Mr. TAYLOR. I mean assuming the figure before is roughly, and I don't have that specific figure, the failure of thrifts prior to FIRREA, but that figure sounds very close. So I assume that figure. But coming forward, from the beginning of FIRREA, to the middle of May, 423 thrifts had been put into conservatorship, of which approximately 95 had been settled. But just to take the load coming forward, 423, there is an additional 299 in a category considered destined for resolution, and another 315 that are in some danger.

So if you take just from FIRREA, through today, in all those categories, you're a little bit above a 1,000, actually 1,037.

The CHAIRMAN. And let me just finish, my time is up, but in your judgment, Mr. Taylor, and you've been deeply immersed in this, is it a reasonable expectation then that we are going to see probably since the date of FIRREA something on the order of a 1,000 institutions that will have to be resolved here? Is that a reasonable estimate for us to make?

Mr. TAYLOR. It's a possibility, and it's the number we used in some of our higher estimates. But actually there is a category within this last group, this 315, whose median net worth is above a tangible 3 percent, and I would not anticipate, unless conditions change dramatically, that all of those would need resolution.

The CHAIRMAN. Well, let's hope not, but if we go back prior to the date of FIRREA, which is of course the starting point that we have just used for your numbers, and we capture those that have failed prior to the implementation and the enactment of the law, we would certainly have a total in excess of a 1,000.

But I think we've got to have some basic benchmarks here so that we sort of understand the dimension of the problem that we're dealing with, and that relates importantly to your difficulty, your inherent difficulty in doing good cost estimates.

I presume good faith on the effort to try to estimate the costs, but I think that the sheer magnitude of the problem here when you get a 1,000 or more institutions helps illustrate the difficulty of understanding precisely what the costs are.

Senator Garn.

Senator **Garn**. Thank you, Mr. Chairman.

Mr. Secretary, as we have discussed at quite great length, you estimate the total cost of the bailout in the range of $89 billion to $132 billion. I have listened to estimates now for the last 5 years and, unfortunately, all of them have been low during that whole period of time—from GAO or whatever source.

However, a few weeks ago GAO came out with an estimate talking about approximately $325 billion and running as high as a $½ a trillion. Now some have criticized that estimate as being exorbitantly high. As a matter of fact, even Bert Ely, who in all of the estimates when he used to testify was the high person. He was more accurate than anyone during the last 4 or 5 years, but I understand even Bert has criticized GAO's number as not being accurate or responsible.

I would like your opinion as to the validity of GAO's estimates.

Secretary **Brady**. Well, Senator Garn, I think if you are trying to look at this problem as we do most other items in the budget, you don't add the interest to the cost of the project. If you went back and took the cost of the Kennedy Space Program, which was $30 billion, and put a cost estimate on that, you would have to add about $62 billion, and instead of costing $30 billion, it would be $92 billion. So I mean I just think that that's a helpful way to go at it. I mean somebody could do that if they want to. You could do the same thing with a house. If you said a house originally cost $125,000, that's what people think is the cost of a house. They don't add to it the cost of interest over a 30-year mortgage. If they did, the total cost of the house would be $383,000. So if you want to look at it that way, fine, but that's not the way we looked at it, nor is it the normal way that items are budgeted in our budget.

Senator **Garn**. Well, I'm a little bit surprised at GAO because back in the days in 1986 when I was trying to get the $15 billion of FSLIC recap passed through the Congress I was primarily relying on GAO's estimates. Most of my speeches used GAO at that time, and they certainly weren't using that method back in 1986, and their estimates at that time were in the area of $25 to $30 billion.

I can specifically remember using those figures over and over again on the floor quoting GAO as my source of why we needed to do something about this. So I'm a little bit surprised that they have changed their method to include all of these other costs. I don't think that realistically helps us solve the problem, and I think it also puts some fear into people that can further exacerbate the problem.

So I'm hopeful that we can work with more realistic estimates and, as Senator Gramm said, the real problem is how we do solve it rather than playing with estimates of a $½ a trillion.

I am certainly pleased that Senator Sarbanes wants to see a fully constituted RTC Board. Secretary Kemp is also Chairman of the Federal Housing Finance Board, and I would like to say that I am also pleased that two new nominations for that Board have been sent up, Dan Evans and Larry Costigleo.

I have heard some discussion about the President's nomination of these Board members being part-time. The status seems to be unclear as to this question.

Secretary Kemp, could you tell the committee why you believe a part-time Board makes some sense or whether we should have a full-time Board?

Secretary **Kemp**. Well, in consultation, Senator Garn, with both the White House and Justice, that decision was predicated on the idea that the change in the status of the regulations of the Federal Home Loan Bank in the past from overseeing the thrifts, the insurance function, the FSLIC and the banks leaves us now in a position of having a more specifically designed role.

No. 2, the Congress put the HUD Secretary on the Board as Chairman de jure until the new Chair is to be confirmed. As you pointed out, in getting members to serve on the Board, I would say that one other very strong reason is that it is important to recognize that the type of people that we have sought, for instance, Dan Evans to be the Chair of FHFB, is now a partner in a major Indianapolis law firm. He has served the last few years as Chairman of the Federal Home Loan Bank in Indianapolis. He is considered to be an outstanding choice.

Frankly, I think it would be very difficult to get the type of service that both Dan Evans and Larry Costigleo, a distinguished New York attorney who spent 25 years with the Saving Banks Association in New York State, deserve.

My belief is that part-time gives us broader reach to men and women who can serve on the Board. Our executive director, Mary Bush, is a full-time executive director. So I feel confident that we have come to the right conclusion and, as I think most of the Members of Congress now know, we have moved ahead with all of our publishing of the affordable housing regs, the dividend policy and the long-term strategy for the Federal Home Loan Bank System that is getting positive comments.

So I feel confident that we have done the right thing and at the right time.

Senator **Garn**. One other question I have——

The **Chairman**. Senator Garn, would you just yield on that point if you are going to move to another subject.

I hear good things about Dan Evans, by the way.

Secretary **Kemp**. Thank you.

The **Chairman**. I haven't had a chance to look at the other one just yet, but don't these jobs pay something in the range of $80,000 or so a year?

Secretary **Kemp**. It's in that range.

The **Chairman**. That's my understanding. My understanding is that it is about $80,000 a year or what-have-you, but on the face of it, it would seem to me, and we have not had a chance this widely as a committee, that by most measures that would be seen as a full-time job, and I don't say that to advantage or disadvantage any possible nominee.

Secretary **Kemp**. I understand that.

The **Chairman**. But this is not the kind of advisory service that one performs at essentially no cost or only expenses. This is a position that has a very substantial salary with it.

So I think the issue of whether or not it is or is not intended to be a full-time job is something that we are going to have to examine with some care. But I should have you give us for the record what the salary is that that pays.

Secretary **Kemp**. I would be happy to.

[The information to be supplied for the record follows:]

Federal Housing Finance Board
1777 F Street, N.W., Washington, D.C. 20006
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May 25, 1990

Donald W. Riegle, Jr., Chairman
Committee on Banking, Housing and Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20510

Dear Mr. Chairman:

In my appearance before the Committee this week as a member of the RTC Oversight Board, we had a brief discussion about the President's nominations to the Federal Housing Finance Board (FHFB). I am pleased to answer your question regarding the compensation of these part-time appointees.

As we discussed, FIRREA provides for the FHFB's Chairman and Directors to be compensated at Executive Levels III ($89,000) and IV ($83,600), respectively. Of course, as part-time positions, this compensation will be allocated on a pro rated basis for those days for which the Directors actually perform FHFB duties. For the Chairman, this rate would be $247.22 per day; the Directors would receive $232.22 per day.

I hope this information is helpful. I would also like to take this opportunity to reiterate why I believe the part-time status of these appointments is appropriate.

The FHFB has one responsibility - regulation of the Federal Home Loan Bank System. This is a fraction of its predecessor's function; the Federal Home Loan Bank Board presided over the entire thrift industry, FSLIC and Freddie Mac as well. While the Bank Board handled all four responsibilities with just three members, the FHFB, with its staff of 75, can efficiently oversee the district Banks with 5 part-time Directors. Moreover, since I, as the Secretary of HUD, am one of those Directors, Congress could not have been intending an all full-time Board.

Finally, but most importantly, we were able to attract a more qualified Board with these positions part-time. For example, our new Chairman-designate, Dan Evans, is a partner in a major Indianapolis law firm who has served for the past few years as Chairman of the Federal Home Loan Bank of Indianapolis. He knows the Bank System well and can serve as a most effective leader and regulator during this time of change. He would not be available to serve full-time.

Similarly, Larry Costiglio is a distinguished New York attorney who spent 25 years with the Savings Banks Association of New York State. He has a lifetime of experience in all aspects of banking regulation, finance and housing. Also, the President has made tentative selections for our other two nominees, which are now in final clearance. This includes our consumer representative Board member. These are equally well qualified candidates who, like many others with significant financial and banking regulatory experience, are available only on a part-time basis. The White House hopes to send them to the Committee soon.

It is important, Mr. Chairman, that we maintain our momentum in implementing the complex task posed by FIRREA. We are entering another year of major debate on deposit insurance reform, Government sponsored enterprises and other issues. The Bank System deserves a qualified and experienced FHFB and we urge your assistance in providing one.

Thank you for the opportunity to clarify this important issue. Please let me know if I can be of any additional assistance.

Very sincerely yours,

Jack Kemp

Jack Kemp

JK/cbh

cc: Members of the Committee

The **CHAIRMAN**. Senator Garn.

Senator **GARN**. Mr. Chairman, I just had one rather quick question, and the light was still yellow.

The **CHAIRMAN**. Yes, I understand. I thank you for yielding. [Laughter.]

Senator **GARN**. I think it's true that not only myself, but every member of the committee has heard numerous reports, complaints and questions about the loan to one borrower provisions of last year's legislation that is causing serious problems and unintended consequences.

If I could just have a response from any members of the panel that would like to speak on that issue and tell us what your feelings are about that particular provision.

The **CHAIRMAN**. Secretary Brady, do you want to indicate who? Mr. Taylor, did you want to respond to that?

Mr. **TAYLOR**. As I understand, the loan to one borrower issue is being worked on by the OTS and they are trying to find some middle road to solve that in transition.

I think certainly from a concentration of credit standpoint that it has been a long-term standing rule certainly in the banking business that lending too much of your capital funds to one borrower is a sure way to provide concentrations that can get you into trouble, and the Congress has seen fit to put a limit of 15 percent on national banks, which seems to me reasonable and operative for national banks.

Senator **GARN**. Well, I would only suggest, and my time is up, that Senator Shelby lead on this issue, and the committee is going to hold some hearings on that particular issue to try and determine where the truth lies because obviously we don't want to place more institutions at risk, but on the other hand, we don't want to lower the value of that franchise either and make it more difficult for you to do your job and put more institutions out on the chopping block. So we will be looking forward to more detailed testimony on that issue.

Thank you, Mr. Chairman.

Secretary **BRADY**. Senator Garn, I would just point out, as Bill Taylor has mentioned, this 15 percent rule is the same rule that commercial banks observe as well.

Senator **GARN**. I understand.

The **CHAIRMAN**. But I assume from the answer that we are not hearing any recommendation at this point at least from the administration to change it by law.

Secretary **BRADY**. That's correct. We are continuing to monitor the situation, but at the moment it is 15 percent.

Secretary **KEMP**. I wouldn't be a very good Housing Secretary if I didn't express some real concern. I share Secretary Brady's response, but hope that in your hearings that I would be called to testify.

Having been out in the field and talking to men and women all over the country, I am profoundly concerned about the abruptness of the new regulations, the new capital requirements, the new loan to one borrower rules and, very frankly, the failure so far at least to give the President a capital gains tax rate that I would think have a very positive impact upon the asset and the portfolios of those thrifts that are in danger as well as those at the margin that have been put into receivership.

So I think that this is something that needs exploring, and I applaud the effort of this committee to take a look at what happened under FIRREA and what happened to real estate and home building and new housing starts under the 1986 tax reform, of which I was a proud supporter, but think that it needs to be looked at with regard to what it's doing to crunch the source of capital and credit to a very important segment of our nation's economy.

The Chairman. I want to try to stay within the time limits as much as we can, and I want to go next to Senator Cranston.

I know Senator Shelby has asked to make a comment on this point.

Senator Cranston. I will be glad to yield to the Senator.

Senator Shelby. I will be brief. Since I have been in the forefront of trying to explore some ways to make this work either administratively, as Mr. Taylor alluded to, but I agree with Secretary Kemp that there is a problem all over the country as far as the crunch because a lot of builders have been caught in the interim without a source of financing, and a lot of them are solid builders and they have been dealing with a lot of solid financial institutions.

So I am hoping that we can work out something, either administratively or through the law, but we are going to hold hearings on it, and I commend the Chairman for agreeing to do this.

Thank you.

The Chairman. Very good.

Senator Cranston.

Senator Cranston. One of the original purposes of thrift institutions was to provide affordable housing, and we have touched on one aspect of that.

Another is that currently FIRREA established special rules for the disposition of single family homes and multi family properties in order to make such property available for low- and moderate-income families. Some housing organizations are critical of the Oversight Board for failing to give the RTC the direction or the tools necessary to carry out the disposition of affordable housing in a meaningful fashion.

The thrift law gave the RTC the discretion to discount prices and provide favorable financing in selling the affordable housing properties. Despite that authority, which is clear, the Oversight Board prohibited the use of direct subsidies, and I can understand there is a cost involved and that was no doubt a consideration.

What happened was that the Board instructed the RTC to provide the Board with an assessment of the subsidy issue by May 30. The Board's decision contrasts with the RTC's recent pronouncements on pricing and auction policies, it seems to me. Housing applicants feel that the Board's decision makes it highly unlikely that the low-income housing mission of the RTC will be fulfilled.

They expect that most affordable homes are going to be sold either to speculators or to individual home buyers at the upper end of the income targeting scale, 115 percent of area medium income. They also claim that the disposition of multifamily property will be made difficult by the absence of subsidies.

I would like to ask how you respond to this assertion or this situation?

Secretary BRADY. Senator Cranston, of course you are familiar with the fact that with regard to affordable housing that there is a 90-day right of first refusal provision that exists now.

We discussed at the last Oversight Board meeting 2 days ago whether we might have some sort of a plan presented to us which gave a discount or a reduction in interest rates to those people who qualify for affordable housing which would try to bring down into the level of those that most need the help the affordable housing that we do have and will have on the books.

So it's a question of perfecting that particular process, whether it should be just a discount on the housing, whether it should be an interest rate subsidy or something of the like. It's under consideration right now, and I think we will have a plan pretty quickly.

Senator CRANSTON. But you do expect to come up with a plan that will help on that trend?

Secretary BRADY. Yes, sir.

Senator CRANSTON. It has been 9 months since the passage of FIRREA. RTC has spent most of that time, of course, gearing up for the disposition of affordable housing properties rather than actually selling those properties. To date I believe only about a 100 single family homes have been marketed for any length of time.

If RTC was not ready to expand its operation, I think most observers could accept that slow pace up to now of disposition. Yet a wide range of people involved in this field, State housing agencies, nonprofit organizations, housing and consumer advocates charge that RTC is a long way from putting in place a strategy to implement the affordable housing program.

There have been no contracts signed by clearinghouse agencies entities which are at the center of the affordable housing process.

Are clearinghouses being set up? Will that be part of the process?

Secretary BRADY. It will, Senator Cranston. I would point out this is the RTC's operating responsibility, and ours is of course a policy role with regard to it. We are, too, cognizant of the fact that out of a rather large amount of affordable housing, very little has gotten out into the hands of those who need it, and it doesn't seem to be of any real use to have those homes sitting in the RTC. So we share with you the value of trying to provide a program that will move those houses faster into more hands and particularly those who can afford it the least.

Senator CRANSTON. Are State agencies and national nonprofit operations being provided enough incentives to participate in the clearinghouse operation?

Secretary BRADY. Well, as you are familiar, I'm sure, those incentives are in the State housing agencies themselves, and we are pleased that we have signed a deal with the State of Texas which is going to make the housing even more affordable than it was before, and we are working, and when I say "we," we understand the RTC is working with other housing agencies to do the same thing in other areas.

Senator CRANSTON. On a different topic, what is your view of "early intervention" by the regulators as a method of protecting taxpayers? In the case of the 266 thrifts with net worths between 0 and 3 percent that could become insolvent, do you recommend the regulators step in and close these thrifts while they still have net worth above zero percent to preserve a cushion where the taxpayer and the Government would be protected from loss?

Secretary Brady. Not really, if I understanding your question correctly. Those thrifts that have net worth of 0 to 3 percent are encouraged to come forward with operating plans which will allow them to stay in business, and I understand that some of those plans can go out past the year of 2000 if they are well founded and make sense.

So the answer to the question is not with respect to that particular group looking to intervene at an early date unless circumstances call for it.

I think the early intervention process is in a different area where we observe the principle that as soon as the assets get into receivership and into the hands of the RTC they immediately decline in value for the simple reason that once the Government gets them people put discounts on them.

So we feel if we can catch the thrifts before they get to the actual point of receivership and market those assets on the way that we will do a better deal in getting more money for the Government.

Senator Cranston. Thank you very much.

The Chairman. Senator Heinz.

Senator Heinz. Thank you, Mr. Chairman.

Secretary Brady, yesterday at our committee's hearing on Federal deposit insurance reform, one of the witnesses cited the failure to promptly close insolvent institutions as a principal cause of the savings and loan crisis, and it is certainly true that insolvent S&L's continue to bleed losses until they are buried once and for all.

We have been talking here today about the number of insolvent institutions, some 330 of them that you have on your hands, and there are apparently another several hundred on the way.

Is it not true that until you dispose of the assets of those institutions that you continue to be exposed to losses?

Secretary Brady. Sure. [Laughter.]

Senator Heinz. That's the best answer we have had all morning. [Laughter.]

Everybody is sitting here in a state of shock and delight I might add.

The question I have got is what has been your experience with the assets that have been sold? Your estimates are based on either low, medium or high estimates of the losses in disposing of real estate. What have we learned over the last 6 months since our last hearing about the disposition of assets? Are we taking high losses, medium losses or low losses?

Secretary Brady. Well, I will ask Bill Taylor to give you the exact figures, if I may, Senator Heinz. What we have learned is that over the last 6 months that the real estate business in this country, and particularly in certain areas has taken a downturn, and that as we try and sell these assets into the areas that we're having less success in doing so now than we contemplated last summer when we all were contemplating putting together FIRREA.

This has two effects. One is a discount on assets, and the second is that banks and others who were interested in acquiring thrift franchises aren't willing to do so any more. It's just not a business which people want to get in.

Senator HEINZ. Before you yield to Mr. Taylor, and I would be happy to have his information, let me generalize my question this way.

Based on the experience of the last 6 months, were you to experience the same return on the disposition and the liquidation of those assets that you have been experiencing these last 6 months in the future over the next 3 years, where would you be, at the high end of your estimate, the midpoint or would you be above the high end of your estimate?

Secretary BRADY. I don't believe we would be above the high end. We would be towards the high end. As you know, Senator Heinz, there are three factors. One is the discount, one is the number of thrifts that come into the calculation and the third is how fast the assets are processed out. All three of those factors vary the estimate, and every single one of them is a function of the state of the real estate market.

So our problem, as we have discussed before, is if we can come out with a forward view of what the real estate market is, we can be somewhat more precise. The problem is that that's difficult to do, but in answer to your question, it's at the higher end.

Senator HEINZ. Now last year when you came before the committee and when the President sent up his FIRREA legislation, a lot of emphasis was placed on the need to act quickly, that the longer we waited, the more costly the problem would be. In effect you were saying that time is money, and as we wait, these institutions lose more money and that becomes more costly to the taxpayer. Is that still correct?

Secretary BRADY. That's still correct.

Senator HEINZ. At what rate are the 330 insolvent institutions that have not been resolved but are in conservator or trusteeship, bleeding?

Secretary BRADY. At what rate are they bleeding?

Senator HEINZ. Right, yes. If it took you an extra year to liquidate them or dispose of the assets, how much more would it cost you if you had to wait a year?

Secretary BRADY. Well, we don't have that figure. We could try and develop it. If you're talking about a running rate, Senator Heinz, that would be one thing, but if you're talking about making an assumption as to what the assets would be worth a year from now——

Senator HEINZ. No, I'm just talking about the running rate. I'm not asking you to make a market projection.

Secretary BRADY. I think we could get you that figure, but I don't have it with me this morning.

[The information to be supplied for the record follows:]

The 330 institutions in conservatorship as of May 14, 1990 experienced about $1.4 billion in operating losses during the last quarter of 1989 [calendar].

Senator HEINZ. Mr. Secretary, let me ask a different question. During our consideration of the S&L bill last year I offered, and this committee and the Senate agreed to an amendment to be sure that the taxpayers, that is to say the FDIC was put at the head of the line when it came to collecting from a failing S&L.

Right now under the law, because the House rejected our amendment, the Federal Government stands in line, sometimes at the end of the line, with shareholders and other unsecured creditors. My recollection is that you supported our amendment, and I intend to offer it to appropriate legislation, possibly the Crime Bill that is on the floor right now, to make sure that the taxpayer gets the money first.

Do you continue to favor our legislation to put the taxpayer at the head of the line in bankruptcy proceedings?

Secretary BRADY. I think we did support your amendment last year, but I would like to check the record on that.

Senator HEINZ. Well, you did. I just want to make sure that you do.

Secretary BRADY. We did, and we would still support that practice. I would like to look at the amendment and get back to you.

[The information to be supplied for the record follows:]

The Treasury Department did not support Senator Heinz's amendment to FIRREA.

Senator HEINZ. My time has expired.

I wanted to ask Secretary Kemp if capital gains was relevant here, but maybe someone else will ask that.

The CHAIRMAN. I am sure it will come up, and he has made one comment on it earlier.

Senator Wirth.

Senator WIRTH. Thank you very much, Mr. Chairman.

Secretary Brady, you are part of the Budget Summit, and I wanted to ask you, if I might, about the relation of the S&L crisis and the financial crisis that we are apparently in. In the last 4 months apparently things have changed very dramatically from the President's State of the Union Message in which we were told that everything was really pretty much OK, and now we are seeing Mr. Darman's projections of gross drop from I gather almost 3 percent to just a little over 1 percent. The deficit apparently is ballooning very significantly, interest rates appear to be on the rise, and Senator Roth has a "Keep the Pledge" button on, and we've got a Budget Summit going on.

What has happened in the last 3½ or 4 months that has made this dramatic change occur from the President's State of the Union Message to the negotiations that are now going on in the Budget Summit?

Secretary BRADY. Well, let me address the question, if I may, Senator Wirth, and I think the essence of your question is why are we bringing these matter up now, and the answer to that is that it's budget time, and the Senate is working on its budget resolution and the House has passed theirs. So now is the time to address those problems.

As to why the estimates are different. To some extent it does reflect the fact that we had a very weak fourth quarter in 1989 which was not known at the time of the submission of the budget by the President, interest rates are different than what we thought they were, although I will say that they have come down as against a year ago.

So there are a number of factors which drive this particular process. Spending is up, and it looks as though the budget deficit will be higher than it was before. So now is the time to face the problem.

Senator WIRTH. Is the growth rate down as sharply as has been reported in your projections of down around 1 percent now?

Secretary BRADY. Maybe it would be better to ask Chairman Greenspan about the growth rate, but the thing that changed projections somewhat is we had a growth rate in the fourth quarter of some 1 percent. It has now returned, but maybe, Chairman Greenspan, you would want to talk to the growth rate.

Senator WIRTH. Well, Alan, we would love to hear from you, but what I want to get into is has the S&L crisis been a lot worse than you all thought it was going to be, and is that in part causing a good deal of the crisis that apparently exists now?

Secretary BRADY. In my opinion, the S&L crisis, Senator Wirth, is what it is. It has really little bearing in my mind on the necessity of facing the budget crisis at this particular time, and I say crisis, not budget problem. The reason why there is so much discussion about the S&L problem in relation to the budget discussions is that in trying to affix a goal for the budget discussions, you have to make some assumption about the S&L problem to see whether you want to include that in those deliberations or whether because of the fact that it varies you put it outside.

In my opinion and in my mind, and it may in others, it has very little to do with the discussions at this point in time other than a technical one.

Senator WIRTH. I think it's interesting that you say that. I think your using the word "crisis" is correct, and the idea that there is a relationship——

Secretary BRADY. I was copying you, Senator.

Senator WIRTH [continuing]. Between the S&L issue and declining real estate values, which we are seeing, is the Federal Government is taking on a lot of this real estate in an enormous amount, and that has got to have a depressing effect out there and more than we all thought it was going to.

Secretary BRADY. If I could, I just want to make clear that during the period between FIRREA's enactment and now only some $43 billion of real estate assets have been sold, and those are principally cash and securities. So there hasn't been, unfortunately, from the resolution process an enormous amount of real estate sold. So I think you could say that the real estate situation may be worse because of the fact that all of this real estate overhangs the market, but you can't say it's because a lot of assets have been sold at this particular point in time.

Senator WIRTH. But it does overhang, and that is having I think a depressing effect, and that is making our financial institutions look less strong, which I understand. I just think that we all ought to understand, and the American people have to understand that this whole set of issues surrounding the S&L are having very significant impacts and are going to for a period of time.

I know you have said that before, and I just find it fascinating that the Summit is going on now and that this has got to be playing a major role in that, and I can see why.

I would like to ask you about the affordable housing program in the time remaining to me. That was touched upon a little bit by Senator Cranston, Senator D'Amato and others who have been very concerned about it as I have. I have been concerned, as Senator Cranston pointed out in his statement, about how slowly the guidelines or regulations have been written related to the affordable housing program.

Now we are in a situation apparently with the new auctioneer disposition rules at the RTC that any unit or any piece of property under $100,000 value can now apparently be auctioned off, and that that value can, if it's on the market for 4 months or more, can drop even more significantly.

Now the affordable housing program has a ceiling of about $67,000 in it I think, and yet we are going to see an awful lot of single units going on the market that are going to be assessed by you all probably at between $67,000 and $100,000, but in the market they are going to be sold at a lot less than that.

The concern that I have is that there may be a disconnect between the auction policy of $100,000 and less and the affordable housing program that doesn't have its guidelines in place.

My concern is that we may end up through the RTC's auctioning program with selling off a lot of housing that ought to be involved in the affordable housing program and that before perhaps allowing the auction of a lot of this housing when it's actually sold for it to fit the affordable housing definition, that we ought to wait for those regulations to be in place, or we should place a very high priority on getting the affordable housing program in place so that the auction and the affordable housing program are fitting together.

I'm concerned that a lot of people who already have access to housing are going to benefit from this auction, but a lot of the people in the country who desperately need housing aren't going to.

Does that make sense?

Secretary **Brady**. I think you have stated both the question and the answer, to be honest with you, and we would agree with your conclusion.

Senator **Wirth**. Is there some way that we can then delay or either accelerate the guidelines or delay the auction so that you get a fit between the affordable housing program and the—is this right, Jack, Secretary Kemp?

Secretary **Brady**. We are trying to do that.

Secretary **Kemp**. We have issued our formal affordable housing program rules last March. The rules, Tim, will make it easier for eligible families and nonprofits and State housing finance agencies to participate in the disposition of these properties.

The Secretary is exactly correct, we are operating on a first right of refusal basis in the interim, and we are anxious to facilitate, Senator Wirth, quicker sales of such properties that would not only decrease the RTC's holding costs and maximize our net return, but help in this overall affording housing program.

We are not only through the RTC, but the FHA as well has entered into the agreement in Texas that Secretary Brady talked about that will allow that housing agency to greatly facilitate the sale and purchase of a portion of FHA's Texas portfolio, and we are doing the same thing through RTC.

Finally, the Board is actively addressing two additional elements of the affordable housing agenda. just for the record, Mr. Chairman, briefly. We are developing guidelines for disposing of properties which would not yield a reasonable recovery if sold and, second, while the RTC's initial marketing efforts indicate we are reaching out to moderate- and low-income home buyers, we are further examining the need for subsidies either by buydown of interest rates or by deeper discounts on the sale. So we are going to be guided by not only the Congressional dictates for an affordable housing program, but also keep in mind the necessity of meeting the goals that have been given to the RTC for protecting the taxpayers.

Senator WIRTH. Mr. Chairman, my time has expired. I think we have an obligation to work with the two Secretaries to make sure that these programs fit and that we don't have one go by the other and lose a lot of the thrust of the affordable housing dictated in FIRREA.

Thank you very much.

The CHAIRMAN. I certainly share that view.

Senator Mack.

Senator MACK. Thank you, Mr. Chairman.

Let me start out by making a statement, and then try to refocus the direction in which we are going here this morning.

The statement has to do with the limit on loans to one borrower. I want to try to stress the importance of making a decision on that. I represent a State that has been growing at the rate of roughly 1,000 new people a day moving in the State of Florida. I also make this statement drawing on 17 years in the banking business.

There is no question that there is a 15 percent cap in commercial banking. There was a different approach to real estate in S&L's because in fact it was a different business. There are builders, developers and contractors in Florida that have had to move away from one financial institution to arrange borrowing in as many as 10 different financial institutions.

And let me express another law of banking. Bankers don't like to make loans to individuals or companies that are borrowing from multiple sources because you have great difficulty trying to control what in fact is going on.

So I would just urge you to look at this. I think it is in fact a serious issue, and it is one that I know is impacting the State of Florida.

Now let me just try to refocus here if I could, and I want to commend Secretary Brady for laying out what has been going on, what the problems and what the numbers are with respect to the number of institutions and the potential cost. If I remember, it has to do with discount, the number of institutions and then the speed in which we sell assets, and then I would suggest that there is not a great deal we are going to do about discount and the number of institutions. That is going to be a process of evolution.

But I would raise that what we ought to be focusing on, at least from my perspective, is the question about the speed of moving assets, and this discussion this morning reminds me of what happens in a debate about the budget. We are always talking about how much spending we are going to cut or how much taxing we are going to increase, but no one ever talks about the growth of the economy. I should say there are a few people who talk about the growth in the economy.

It seems to me that what we ought to be talking about or focusing on is what is happening in the economy, and I would say to anyone who wants to respond it seems to me that there are questions about the capital gains rate and will that in fact affect the economy, will it create a larger pool of funds in which the people will then go out and buy these assets, and should we be making the change with respect to the loans to one borrower rule?

I would like to hear from the gentleman that is on the panel with respect to real estate as to his suggestions about things we ought to be doing in the Congress that will affect the real estate market and make it more attractive and make that market move once again, and I would like to hear from Alan Greenspan as to whether he thinks that there ought to be something done with respect to the money supply to offset the contracting of credit that is taking place in the economy.

So having said all of that, whoever wants to hop in, go for it. [Laughter.]

Mr. LARSON. It is indeed an invitation, Senator Mack. As one of the two new boys on the block, I can assure all of you that there is enough work to be done by all of us to address the kinds of concerns that you have identified.

Certainly I have been impressed in the short time I have been working with my fellow Board members and the staff at the energy and the commitment and mostly the creativity that is being brought to this process, and I think we need a good deal more of that if we are going to pick up the pace.

Therefore, I don't want my comments to be misinterpreted at all. I think there is much to be done in the Oversight Board, and I think there is much to be done in the RTC, but I think as it relates particularly to financial institutions, real estate in general and the relationship between the two that there is a good deal that others can do as well.

I think serious consideration on the capital gains issue is clearly related to the health and strength of real estate markets, and I would encourage that debate to go forward promptly. I think it would have a material impact on the problem as we are confronting it.

I believe those elements of the 1986 Tax Act that were largely unintended, but nonetheless punitive to real estate and which are being examined by some of you need to be addressed. I would talk particularly about passive loss and most of those issues that frankly had an unintended adverse impact on the industry.

I believe the kinds of initiatives, such as the one that Chairman Greenspan took the other day along with Chairman Seidman and the Comptroller of the Currency in terms of injecting a rational dimension into the concern about real estate credit was very useful, and that activity needs to be continued so that the kinds of generalizations about tougher regulatory standards and/or credit standards and credit availability, that we substitute for those generalizations, situation specific sound and prudent credit standards and banking decisions.

It seems to me that it is clear, and we have plenty of evidence in the Oversight Board that it is clear that credit decisions and lending practices needed more discipline and that is certainly true in the real estate industry.

But to generalize and to constrain capital to an industry that is such an integral part of both our economy and this problem is I think not a desired result of the tougher enforcement standards.

Senator MACK. Does anyone else want to respond to that question?

Mr. JACKSON. Well, Senator, this seems to be independent time in the hearing I guess. I must candidly differ. The purpose of a financial institution which is designed principally, and I'm sure Senator Gramm would share this judgment as a former college professor, as a depositor intermediary, is to diversify risk. That is one of its underlying purposes. That is chapter one in the course in money and banking. And any time you violate that rule, it will be at the public's peril, as we have through the cost of the type of situation we are engaged in today.

I think the issue that my own Senator Shelby is addressing and you are addressing is the transition process by which we go from a prior practice to a more rational, long-term relationship between risk of any financial depository intermediary and any single borrower. This is the problem, and not where we ought to end up.

I hope the Congress will never abandon the fundamental task of making sure that, one, we have adequate capital so that the public doesn't pay the first loss and, two, that these organizations diversify risk.

Senator MACK. I don't disagree with that, but my main point was to say there is a sense of urgency and there should be recognition of the need for a transition period, and it has been dragging on too long, and a decision needs to be made on it.

The CHAIRMAN. Thank you, Senator Mack.

The Chairman of the Budget Committee, Senator Sasser.

Senator Sasser.

Senator SASSER. Well, thank you very much, Mr. Chairman.

Mr. Secretary, it is good to see you again today. We seem to see each other on a daily basis these days, and it's good to have you here before the Banking Committee today.

When we passed the FIRREA bill last year, the Congress was told that what we really had with the S&L's was a $40 billion problem, as I recall, and we tacked onto the $40 billion problem an additional $10 billion for working capital. So we provided about $50 billion.

Then a month later the Chairman of the FDIC, Mr. Seidman begins stating publicly that $50 to $100 billion would be needed for working capital, and not the $5 or $10 billion that we had originally thought.

Then we saw the President's budget come up in January for fiscal year 1991, and the budget did not contain an estimate with regard to the S&L problem. As a matter of fact, it had zero for working capital.

Now I have been sitting here doing a little calculation, and you correct me if I'm wrong, but it looks to me like the RTC is going to be spending about $150 billion more on a cash basis over the next 5 years.

Now that appears to me to include all of the RTC spending. That will be on top of the $50 billion already provided to the RTC in the FIRREA bill, and the $24 billion that was provided to SAIF, the Savings Association Insurance Fund, in last year's bill.

And then we have on top of that a rumor circulating around here that Mr. Seidman is going to say that the FSLIC resolution fund needs $30 billion or more to pay for the old FSLIC deals.

Now that totals to well over $250 billion over the next 5 years.

Would you agree with that analysis, Mr. Secretary, or am I off base there?

Secretary BRADY. Senator Sasser, I can't follow your figures exactly as they come at me, but I stand by what the testimony said, which is that we think that a range of $89 to $132 billion, which includes the $73 billion that we said was provided before, $50 billion for RTC in the FIRREA legislation and $23 billion to SAIF, is the figures that we would stand by. I think maybe you may not have been in the room when we went through the calculations before, but that would provide as opposed to the figures that were put forward in September of last year, a total amount of $16 to $59 billion more than was estimated at that particular point in time.

I'm not sure how much working capital figures are in the figures that you have just given this morning. So I would have to look at those, and again the working capital provisions are ones that vary with the speed of asset resolutions and dispositions. So I would have to take your list of figures and compare them to the ones that we have.

Senator SASSER. Well, let me ask you this, Mr. Secretary. I think we would agree that we have got a much larger figure here than we originally had. We originally anticipated at the outset of this, back in 1989, although many thought at that time that the magnitude of the problem was being underestimated, but we do have a larger problem now than we did then.

Now the question comes, what are we going to do about handling this financing? Does the administration want the bailout costs on-budget or off-budget? What does the administration want to do about Gramm-Rudman-Hollings? Do we want to exclude these costs from the Gramm-Rudman-Hollings targets, or does the administration want to stretch out the targets? What is the answer to that, because we clearly cannot accommodate it with the present Gramm-Rudman-Hollings structure?

Secretary BRADY. Well, Senator Sasser, let me say, first of all, that the numbers vary by what happens to the real estate market, and I'm going to get to the answer to your question in a second. But no room full of business school graduates will give you a better answer than we have given you. Unless somebody picks the level of discounts, the number of institutions and the speed at which the assets are going to be processed, and I would no more speculate on that figure than I would speculate on the stock market.

But with regard to the budget discussions, the answer to your question about what to do is that if you can deal with a range which is in the magnitude that has been discussed this morning, that is the problem we have got in the budget discussions, and at this particular point in time, as you know, that discussion to discuss the size of the range has those figures, and I think that budget group has got to decide what we want to do with it.

If you ask me as a personal matter with regard to working capital, the normal course of action with regard to working capital in every corporation in the United States is not included in the operating figures. When a corporation goes to borrow money to build "*x*" number of more cars, it doesn't adjust its income account, it budgets for that basis other than the cost of the interest on that matter.

So I can see a set of logic that would indicate that you don't want to complicate an already complicated budget negotiations and deliberations by swinging it back and forth with respect to working capital. It could be $50 billion worse this year and $30 billion better the next year, and it would raise havoc with the Gramm-Rudman target.

So as I see the logic proceeding, it seems to me that it's becoming more understood that that's a problem that is very hard for budgeters to deal with.

With regard to the loss, I think we can only give you what our range is of that loss and say that that has the same characteristics as the working capital swing. It will swing your estimates around.

I personally try to be as precise as I can, and I would like to get down, in the budget discussions, to something that doesn't swing around. On the other hand, if there are those in the budget discussions who feel that this ought to be recognized in some certain way, that you ought to put a plug figure in the budget, that is a way of going at it, but I think those who take that point of view ought to realize that they are going to have to come back and visit the problem perhaps very quickly as the real estate market either gets better or worse.

Senator SASSER. Thank you. My time has expired.

The CHAIRMAN. Thank you, Senator Sasser.

Senator Roth.

Senator ROTH. Thank you, Mr. Chairman.

In my opening remarks I said that, rather than striving to raise taxes, we should be looking for ways to curb the S&L losses.

In yesterday's Wall Street Journal I submitted what I thought was a possible proposal entitled "Use Treasury Securities to Cap S&L Debt."

Now while my proposal wouldn't necessarily save money in 1991, I would hope that it would not be dismissed for that reason. If successful, my proposal would end the perpetual financing of the S&L bailout, which is the probable result of the current plan.

The current plan is to sell assets as soon as practical at the market price, and I applaud that. The additional losses resulting from such sales will eventually push us beyond $50 billion in net losses, and these losses will be financed in the traditional manner through various Treasury securities, which on maturing will be refinanced ad infinitum.

Now my proposal, Mr. Chairman, would, in a sense, combine the sale of assets and the sale of securities in one package. Each asset would be guaranteed to rise in value to equal the sum of the current value of the asset in the security. The purchaser would have to earn a return on the asset and would be paid a return in the form of interest on the security, thereby realizing an enhanced return on his purchase from the beginning.

For this the purchaser would be expected to pay the fair market value for the asset and for the security. Because of the guarantee, the package would, in my opinion, be attractive to institutional investors. In contrast, I do not believe they are interested in the current plan.

I'm confident that in some period of time, whether it be 8, 15 or 20 years, whatever the term of the guarantee, the assets will rise to full value. In other words, I am confident that in time inflation will assist rebounding values so the Government will not have to pay on the guarantee and the endless cycle of refinancing would be terminated.

Now as the Wall Street Journal article says, "if the interest were offered to asset purchasers as a guarantee of income rather than to purchasers of Treasury securities, the worst that could happen would be a wash."

I don't know whether any of you gentlemen have had an opportunity to look at this proposal. I did write to the Board some time ago and received an answer from Mr. Taylor saying that it was the RTC policy to avoid long-term obligations to asset purchasers. He drove home the point by alluding to the FSLIC deals which drew so much fire from some Members of Congress.

My question is this, does it make sense to make what is in effect a perpetual obligation to purchasers of Treasury securities while avoiding a finite obligation to purchases of RTC assets, as I propose in my article?

Secretary **BRADY**. Senator Roth, I believe your article appeared 2 days ago, and I think that is when I read it, and we have it under study, but within that short period of time we haven't been able to come forward with a complete reaction. There are many good ideas in the article that we need to look at further. So if you would give us a few more days, we'll get back to you.

Senator **ROTH**. Well, I would appreciate that. I realize that while it was written earlier, it only appeared yesterday. But I do think it offers some hope of avoiding a perpetual commitment to finance losses through U.S. securities.

Does anyone else on the Board have any opinion at this time? Secretary Kemp or Chairman Greenspan?

Chairman **GREENSPAN**. Well, Senator, I glanced at the article. I didn't read it in detail. My initial reaction of where the evaluation process has to focus is the willingness of the buyers to pick up properties with and without your plan, and the question really gets down to the issue as to whether in fact the capital gain that might ensue, whether that capital gain does to the original purchaser or back to the Federal Government will very obviously determine the initial price which the individual is willing to pay for the property.

I think what has to be evaluated is whether the procedure that you set out sets up a situation in which the likely price which the property purchaser is apt to bid in the current context would be sufficiently higher because he would get the capital gain than in your context.

It's an issue therefore of evaluating whether the prospective capital gain creates a present value in the eyes of the purchaser at this time which is greater than the amounts that would be discounted in your particular formula. I think that is where the analysis has to go, and I frankly having just read it do not have an ability to make that judgment.

Senator ROTH. Under our proposal we would of course guarantee the gain.

Chairman GREENSPAN. Well, no, I think that what happens is that you remove the expectation or possibility of the capital gain from the purchaser, and that has a significant but indeterminate value at this point, and it is that I think which has to be focused on to be able to make the relative judgment.

Senator ROTH. Secretary Kemp.

Secretary KEMP. Well, I just wanted Mr. Chairman, to applaud Senator Roth's efforts to go through this Summit in such a way as to make sure that we do not do anything that damages an already fragile economy. Secretary Brady made it very clear that the health of the economy has an overall impact, as I know Senator Roth and Senator Mack have pointed out.

While I applaud the effort, I think it does need to be looked at very carefully, and Chairman Greenspan made a very important point with regard to the capital gain being removed from the appreciation of the asset in exchange for what? Nothing more than guaranteed interest which you could get in a lot of other places. It would compete with "T" Bills, for instance.

So I certainly applaud your effort. I believe that Secretary Brady's comments, that it needs to be looked at very carefully is correct, but your overall efforts, Senator Roth, are muchly to be appreciated.

The CHAIRMAN. Let me now call on Senator Shelby.

Senator SHELBY. Thank you, Mr. Chairman.

I have three questions that I would like to get into.

One, I don't want to beat the horse to death, but the numbers that everybody keeps talking about, if you don't know, and I don't know that you know, I mean there are judgments and contingencies that come up, if you don't know what the total costs are going to be, and I don't know how you could really know, why don't you say this, because there is going to be a big multiple, and I believe that is Secretary Brady's phrase, a big multiple out there. We don't know what it is, and you see numbers from the GAO that scare the heck out of people.

Are those numbers so far out when they are talking about a possible $500 billion? Is that way off the board, Chairman Greenspan?

Chairman GREENSPAN. These very large numbers invariably occur as a consequence of adding interest payments on borrowed money over a protracted period of time.

As Secretary Brady indicated, I don't think that we get a proper view of the relative values. The size of this problem is certainly large enough for anyone to want to choke on, but let's get realistic numbers, but far more importantly let's understand what the numbers very specifically mean, and there are various different types of ways of looking at this process and adding up different numbers, but we are continuously looking at apples and oranges and, as Secretary Brady says, the number which gets caught up in the press inevitably, because everyone is looking for it, is the biggest number. It might be useful to look at that——

Senator SHELBY. The biggest number, the biggest headline, right?

Chairman GREENSPAN. I think that there isn't a media person in this room who wouldn't be drawn to that, and you've never seen somebody come up with a statement that the estimate for the savings and loan bailout can be as low as. No one will say that. [Laughter.]

So the point I think that is very important for us to realize is first to understand, one, that the Federal Government has an obligation to meet these costs irrespective of what the actual number turns out to be. The Congress has committed to that, and I think what is crucial here is as we need to know the numbers, and in fact in this Budget Summit I think you do need to know some orders of magnitude.

But until the Budget Summit, very honestly, there hasn't been a real operational need to have a precise number.

Senator SHELBY. Chairman Greenspan, I agree with what you're saying. We need to know, and this committee and the Senate needs to know because we have had witnesses to testify for the last 4 years since I've been here, and most of those numbers were lowballed. And then we come back and we have to answer to the taxpayers just as you do.

It seems to me that first in line not to receive something but to take something from them is the American taxpayers. We are going to stand behind our banking system. I believe that is a given, but we need to know, as you and your colleagues need to know where we are going. Is it out of control? Are we making real progress there? That is the purpose of this meeting today.

Chairman GREENSPAN. I certainly agree with you, Senator. I think the crucial question is I think as Senator Gramm said, that it's not what the size of the number is, but what are we doing to get it at a minimum whatever the number is.

Senator SHELBY. How are we going to resolve it and how fast are we going to resolve it?

Secretary BRADY. Senator Shelby, I'm glad you brought this point up because I think it's very important that the American people understand the answer, and the answer is simply this. The size of the S&L problem almost totally, about 90 percent, depends on the size of the real estate problem in this country.

Now you don't have to do more than drive out to Dulles Airport and look at the new buildings or go to each one of our home towns to see the fact that we are overbuilt in this particular country. This is not meant to be a scare talk because we will live through it just like we lived through everything else.

If you give me your estimate of what discounts we're going to have to apply to the real estate problem and how deep or how shallow you think that is going to be, I'll give you a precise number. I would be glad to. I don't mean to be flip, but the estimates that we provide are totally a function of how much overbuilding there has been in the real estate industry in this country. And if somebody can give the exact answer to that question, we'll give you very precise numbers in a very short period of time.

Senator SHELBY. I don't disagree with what you are saying. I do want to direct my next question to Mr. Jackson and Mr. Larson, who are new, but not new in the real estate business.

I believe both of them were at the hearing and we talked about marking down real estate, Secretary Brady, to mark it like you do everything else, and that's the only way you're going to realize the numbers you're coming up with.

Mr. Jackson and Mr. Larson, do you want to comment on that? Where are we going with these assets as far as marking them to market, in other words, realizing what we can in a prudent way?

Mr. Jackson, we have to be extremely careful, Senator, that we differentiate between an appraisal, which is some informed person's opinion of the likely market value versus the factual situation of at what price would some informed buyer be willing to put up the money and accept the deed for the properly.

Senator SHELBY. Absolutely.

Mr. JACKSON. And I think that is the process that is causing confusion in the minds of many people because, unfortunately, many of the assets originally come into the system based on the former concept and they go out under the latter, and that is producing the disparity of the figures.

Senator SHELBY. Chairman Greenspan.

Chairman GREENSPAN. I never did fully answer your question with respect to the GAO numbers and the comparison that is being made today.

Unless I am mistaken, the numbers that Secretary Brady is presenting are actually higher than the GAO numbers on a comparable basis. And the reason for that is that their implicit number that goes with the ranges that he outlined is lower than what the Secretary is raising today, and I think it's important to distinguish what we are dealing with because we will never get a handle on at least these rough ranges unless we're talking about the same thing.

Senator SHELBY. Mr. Chairman, may I make one brief comment.

The CHAIRMAN. Yes, please.

Senator SHELBY. Secretary Brady mentioned one thing that I guess would get into aggregate costs, and he drew the analogy to buying a home and the interest you pay. I think that has not really been pointed out when we were talking about numbers. We're talking about total numbers, including interest, in a lot of instances and some witnesses, whereas people could probably better understand the initial numbers going in.

The CHAIRMAN. But I think it's important to note, Senator Shelby, if I understood Alan Greenspan correctly, he is now saying that the estimates we're hearing today, which have tended to be presented in present value, if they were extended out over the 30-year timeframe, or the 40-year timeframe with the interest payments, such as the GAO did in their analysis, you would have a number that in aggregate is actually bigger than the GAO number.

Chairman GREENSPAN. I think that is correct.

Senator **Shelby**. But that is over, if you would yield, that is over the life of the whole thing.

The **Chairman**. Oh, I understand. but that's his point.

Chairman **Greenspan**. That's correct. Let me put it to you this way. The cost of this particular program is a cost which can be calculated now if we knew enough about what the underlying values were.

How we finance it is crucially important, but it is how we finance it and not what the problem is that determines the size of that other 30-year money. And how we finance it is a wholly different issue and should not be combined with this problem because this is a difficult enough problem as it is. The size of this hole is astronomical, but let's understand what the accounting is so we can get our hands around it and not have vague numbers which I think undercut our ability to understand the size of what the true difficulty is.

Senator **Shelby**. I'm not undercutting your ability. I'm trying to help you resolve it, but we work in the context of numbers put out in various publications before this table here, as we all know.

Senator **Shelby**. Thank you, Mr. Chairman.

Secretary **Brady**. Mr. Chairman, can I just amend one statement that you said.

The **Chairman**. Yes.

Secretary **Brady**. I think that the GAO numbers also include the past FSLIC resolutions. So that the number would be different to that extent, too. Our figure here is the requirements of your request to us and deal only with the RTC losser and not the past FSLIC requirements which are going to be addressed at some later date, I think a month from now. So there would be that difference as well.

The **Chairman**. Very good.

Senator Gramm.

Senator **Gramm**. Mr. Chairman, let me use an analogy that I have found helpful and that I think applies in this situation. We have had a competition for who was to come up with the biggest number. Most of the numbers have been generated in a way that would be, I think, almost perfectly equivalent to going out in the audience and finding some guy and saying, "How much do you owe on your house?" The guy gets out his statement from the bank, and he looks down here at this money, and he says on my principal I owe $100,000. Then you say, "Now wait a minute. For 30 years you are going to be paying interest on this house, and what you really owe is the principal plus the interest payment that you are going to make for 30 years. You really owe $327,457.19." That same process for the S&L crisis is run on the front page of every newspaper in America and has been read, and it is absolute nonsense. But, anyway, that makes good headlines and sells papers. So it's the bottom line that makes good sense. [Laughter.]

Now I want to talk about the affordable housing initiative in Texas, and I want to thank Secretary Brady and Secretary Kemp for picking this initiative as the first in the country. It has not escaped your memory that I did not think highly of dedicating somebody else's property to a social purpose.

In this case, there is no syphoning off of resources that should be used to pay for the S&L bailout, and that is an important distinction. Moreover, given that the Congress in its lack of wisdom decided to make the S&L bill a housing bill, doing it in Texas first makes eminently good sense. [Laughter.]

I do want to take a moment to outline the program, because I think it would be instructive to see how this program works in Texas and where it came from. A year or so ago, we ended up with some HUD housing in Texas, Jack, that was not on the tax rolls, and it was being torn up. So we came up with an idea of getting the State to issue some bonds, and then having what we call our "Texas Homeowner Initiative" under which we set out what are the characteristics you normally find in Americans that own their own homes.

Those characteristics are that they work hard for a living, they tend to be able to hold a job, they tend to be households that are stable. Now, we didn't have many houses. I think we had 140 or something.

But we decided to try a pilot program where we were going to go out and find people that met all of these criteria, all the criteria of homeowners except for the fact that they were poor. A perfect profile would be a guy that has been a janitor in an elementary school for 14 years and like clockwork he is there. He always comes to work and he always pays his bills. His wife works as a waitress. They've got all the characteristics of people that own homes except that they are poor.

Anyway, to make a long story short, we sold all 140 or so of the houses. None of them have come back on us. And so when this group of RTC properties came up, the Texas Housing Authority decided that this was a golden opportunity. They took all of their bonding power, $140 million. What we are going to do is bring their financing together with 3,000 of your homes. My guess is we are going to get more for those houses than if we simply put them up for auction. We are going to try to implement that same program that worked so well before.

If other States are interested, they might look at what we are doing in Texas, because I think it is a very good program. It deals with a major complaint I hear from people that want to buy your property, and that is that they have no financing.

In this case the State is providing the financing, and the Federal Government through the RTC is providing the housing. I think is a good mix and one that we ought to try to be trying to replicate. And I note that it's a lot different than simply saying, no matter what they are willing to pay, we are going to sell this housing for low-income use.

Here we're coming up with a system that is going to get us top dollar and is also going to help people. So clearly we are going to be doing the Lord's work.

Secretary **Kemp**. In Secretary Brady's prepared remarks that were put into the record formally there is a thorough explanation of your comments, Senator, with regard to what the RTC sees as a great opportunity not only in the State of Texas, but with other States. The RTC is now negotiating with State housing agencies in several States that would parallel the effort being made by FHA in the State of Texas Housing and Finance Agency, which I agree with you has proven to be a very solid, prudent homeownership opportunity strategy.

And I am pleased to say to you that I agree with almost everything you said except one thing. Housing itself is good social policy, and showing that good economic policy and good social policy are inextricably linked together seem to be not only the policy that this administration wants to follow at HUD generally, but I am pleased to say that in March the Oversight Board did approve a policy statement encouraging RTC to do in several other States what we are doing in Texas.

So we appreciate your comments.

Senator **Gramm**. Well, I appreciate your help.

The final point I want to make is that it makes me nervous when I see a new letterhead. [Laughter.]

And I know it gets cumbersome, but I want to urge you to get rid of this letterhead and go back to a rubberstamp. And if you're going to put signs up on doors, have it so they peal off. I used to worry about property dumping, and now I worry that all these people with the Oversight Board and RTC are going to get Federal retirement. [Laughter.]

It's the permanence of this that frightens me. I hope that the mentality that you will generate is that, "we are here. We are here briefly. We are to deal with an emergency, and we are going to deal with it and then we are going to be gone." And I think the way you could help do it is get rid of this letterhead and get a rubberstamp so that you keep the proper mindset. [Laughter.]

Thank you, Mr. Chairman.

The **Chairman**. Senator Kerry.

Senator **Kerry**. Thank you, Mr. Chairman.

Mr. Secretary, recently, and I don't remember precisely where it was, but Bill Sessions announced that he thought that as much as 60 percent of the S&L cases were the result of fraud.

First of all, do you agree with that assessment of Bill Sessions? Has the Board looked at this issue of the amount of fraud and made any judgment with respect to it?

Secretary **Brady**. I'm going to ask Bill Taylor to answer that.

Mr. **Taylor**. I thought what he had said was that 60 percent of the thrifts involved some fraud as opposed to it necessarily being the major cause.

Senator **Kerry**. Involved some fraud.

Mr. **Taylor**. Involved some fraud, right.

Senator **Kerry**. And Bill Seidman has said that he believes the figure may be as high as 30 percent of the failures directly attributable to fraud. Has the Board made any assessment with respect to that figure?

Mr. **Taylor**. No, but we have talked to the RTC and Bill Seidman's people about that and look forward to their analysis. We try not to get involved on a case-by-case basis.

Senator **Kerry**. Understood. I recognize that, and I know yours is an oversight capacity and they are directly doing the case-by-case.

I think Americans are generally speaking extremely disturbed by the notion that as much as 30 percent of the failure itself may be directed attributable and that 60 percent may have these broad aspects of fraud in it.

It's my understanding that the Justice Department now has some 1,300 cases referred to it. Is that correct, or is it more than that?

Mr. TAYLOR. Actually I think the testimony states a substantial more than that as far as criminal referrals go, closer to 18,000. The testimony states that total referrals on possible criminal activity are over 17,000 cases in the last 3 years.

Senator KERRY. Thirteen hundred major cases? I believe my figure is 1,300 major cases. The staff just clarified that for me. I know the figure is enormous. I just heard it yesterday, and it was growing at something like 700 a week or some extraordinary figure like that, and it's good that the investigations are being done that are demonstrating this.

My concern is that 1,300 major cases are sitting there, and it's my understanding that at the moment the Justice Department intends to proceed on only about 11 or 12 cases.

Can you comment on that?

Secretary BRADY. Senator Kerry, I had better get you the right answer. I think that sounds terribly low. One of the problems is that these are extraordinarily long enduring white collar cases and it's very hard to get convictions, and it takes an enormous amount of time.

I think, however, what we had better do with regard to your 11 is to find out exactly how many that is. That sounds low to me.

Senator KERRY. Well, the context in which I bring this up is several-fold, but most importantly when we enacted FIRREA we authorized $75 million for the prosecution of fraud. The administration has come back and sought only a $50 million appropriation, $25 million less, notwithstanding the fact that Bill Sessions and others have articulated very clearly the complexity of these cases, the enormous number of personnel required for any kind of white collar crime prosecution, and I'm not sure how you reconcile the request for only $50 million while agencies in the administration are suggesting point blank that they don't have the resources to do it, and obviously if there are 1,300 major cases and 18,000 cases, I don't think Americans are going to be very happy knowing that there is not going to be an effort to recover the maximum amount of recoverable assets.

Secretary BRADY. Well, I think there is no question but you are on to something that is extraordinarily important, and that is the outrage that the public feels, and it is shared by I know yourself and others, at the amount of fraud that has been present in the S&L situation.

I understand from the Justice Department, and really the comments should be addressed to them, that they are putting on top flight teams on the problem. With regard to the amount of money, Senator Kerry, I guess some part of that discussion involves the whole budget negotiations which are very tight.

Senator KERRY. I understand, but since you are such an integral factor in those negotiations, I really wanted to raise it with you and with this panel and also because I think that the Oversight Board will have an enormous influence in its priorities and in its own focus, and if the Oversight Board is stressing with the Justice Department and the President the importance of this recovery process as a means of diminishing the national anger and as a means of encouraging I think support for what is obviously going to be a fairly contentious process anyway, I think it's in your interest from the perspective of credibility to try to push that, and that is the reason I articulate it. I think it's important.

I also would like to raise with you the issue, because it is directly under your jurisdiction, with respect to money laundering. Allegations have been made, and a number of U.S. attorneys have already issued indictments, and there are allegations made in a number of parts of the country, southwest Texas and Florida, that significant S&L assets may in fact have been laundered in one form or another to offshore banks or to cardboard entities in other countries, and I'm specifically concerned that perhaps that should also be an area of further inquiry and focus.

Secretary BRADY. Well, as you know, Senator Kerry, because we have been involved together on the question of money laundering, it takes place wherever money changes hands, and of course the drug dealers have got a big part of it if they can find some cover.

I recently spent a whole day in Florida with a task force that is under the money laundering banner, and it turns out that one of the things that they had successfully gotten into and caused an arrest to be taken was in a money changing institution which had a close relationship to an S&L, but there is no question that we have to spend plenty time at it, and we are.

It's also a matter I might say of discussion among Finance Minsters all over the world now because as the drug problem spreads, so has the concern in countries such as England, France, Japan and elsewhere that we've got to get on top of this and your legislation has been very helpful.

Senator KERRY. I appreciate that, Mr. Secretary.

If I could just ask one last question, Mr. Chairman.

The CHAIRMAN. Well, we are really pressed and we've got to get Senator D'Amato in. I think you could make a comment, but it's going to be a question and somebody is going to answer——

Senator KERRY. Just as a comment then, if I could frame it as a comment to both Secretaries. I am concerned about the affordable housing pricing setting in terms of the $67,000 versus some of the houses that are appraised, and obviously we know one of the major problems in this whole crisis is overappraisals, phoney appraisals, enlarged appraisals.

It seems to me if some of those appraisals were to be reviewed so you could bring some of that housing down under that cutoff, we would be able to get more homes into the affordable housing, and I think you would be able to dispose of more assets more rapidly.

So I just wanted to raise that.

The CHAIRMAN. That's a very good point.

Secretary KEMP. Can I just quickly respond. The regulations and the effort that we're making through the RTC, those are not cast in concrete or etched in stone. We are looking at it and monitoring it and have as our loadstar the same desire to impact favorably on affordable housing as does the Senate. Secretary Brady has alluded to this and I have, and I can assure you that we are going to look at this very carefully over the 90-day experimental or test period and come up with an even more progressive way of meeting the challenge that you and we accept.

Senator **Kerry**. Thank you.

The **Chairman**. Very good.

Senator Garn wanted to make a comment and then Senator D'Amato.

Senator **Garn**. Thank you, Mr. Chairman.

Senator Kerry, in response to your comments about the amount of money, I would like to respond rather directly from having talked to the attorney general yesterday and putting things in proper order. I think it's fair to say that on this committee that the one Senator who brought this up first and foremost and yelled and screamed about it the most was Senator Bond, and in a meeting yesterday he asked the attorney general about how they were proceeding and why the money wasn't being spent more rapidly.

The administration request for $50 million came first. We upped it in FIRREA to $75 million. So the request was not after the $75 million, but it was before, and we increased it.

Now you are well aware of the process of authorizing, and that is all we did, but then there is an appropriations process which I happen to be a Member of the Appropriations Committee. Whether the amount was $50 million or $75 million in the authorization process, until Congress appropriates it and makes it available, no additional money, regardless of what was requested in an authorization, was available to Justice until December. So in December they started getting money. The attorney general said they were gearing up as rapidly as they could, and simply that they didn't have the number of people or more particularly the experience within Justice to tackle a problem of this size.

So the amount of money, whether you had $50 or $75 million, or $75 million or $100 million couldn't speed up the process of finding these people. Accountants and attorneys who are experienced in following these paper trails said that it isn't like you've got a burglar and you've got some evidence and you bring them in and you process them and prosecute them quickly, but in order to convict, it is a detailed process of going through all the paper trails, and that he had heard this rumor about 11 or 12, and his comment was that that was ridiculous, that they would go after everybody as rapidly as they could and would hope to prosecute as many and send as many to jail.

He was very firm and very definite in that opinion of saying we want to go after these people, we are hiring and we will spend that money.

Now everybody on this committee agrees with you, Senator Kerry, that this is something that should be done, not just because the American people feel strongly about, but just the basic principle that if people have cheated anybody, they ought to be punished for it. That is the basic reason we ought to go ahead with it, and I was satisfied that the attorney general agreed with what all of us are saying here today, and he would move as rapidly as he can.

Senator **Kerry**. Well, my only comment, and I really wasn't bringing it up in any sort of who did what first routine or anything like that, but I have run one of the 10 largest district attorney's offices in the United States and I have started white collar crime units and I have personally prosecuted them. And I can tell you that it wasn't a subject of the dire emergency supplemental, and I can tell you that it has not, from my perspective, been on the front burner in terms of the gathering of evidence or the whole process of preparation.

Now I'm not trying to make it into a partisan thing. I just want to see it done.

Senator GARN. Well, neither was I, Senator. It just was mentioned because no one seemed to know exactly what occurred, and there happened to be a conversation yesterday with the attorney general.

Senator KERRY. I'm convinced that it hasn't been the kind of priority that it ought to be.

The CHAIRMAN. There is a simple way to solve it. Let's put the $25 million into the budget package at the Summit and do it on a bipartisan basis, and let's hire more lawyers and get out and get this work done. I mean that seems to me to be a pretty solid answer, and I would hope that those people think about it if they decide they want to do that.

Senator GARN. They are in the process of hiring several hundred.

The CHAIRMAN. Well, they may have to hire several hundred more. I mean you've got a lot of cases.

Senator GARN. Again, you and I have agreed all the way along, and I'm not trying to create a controversy here. I have been trying to make the point that no matter how much money you appropriate, and I am not opposed to the additional $25 million. That is not my point. But you've got to find the type of people who are willing to come in—and to find hundreds of them at a time has delayed the process—that have the ability to go in and do this tracking. I'm sure you would agree, Senator, from your experience, that white collar crime is difficult to prosecute, and I am not an attorney. This is from listening to my attorney friends, it's difficult and much more tedious than getting a burglar or car thief or something like that, and you don't want to go to all that expense and not have the evidence to put them in jail. So you've wasted a lot of that money, but you didn't get the conviction, and that's the only point that I was trying to make in repeating what the attorney general said yesterday.

Senator D'AMATO.

Senator D'AMATO. Thank you, Mr. Chairman.

I know that as it related to the issue of flexibility the loan to one borrower has been brought up as an example. There are others, and I'm talking about flexibility for the OTS. Now that is not to keep bad bankers in business, but do we need additional flexibility to keep those sound bankers who are presented with a law in OTS that has no flexibility that is going to move as a consequence banks that could make it into the failed category and thereby exacerbating the problem for the taxpayers and costing billions of dollars.

Now I have to tell you there is a sense of frustration that this Senator has. I spoke to Mr. Ryan during his initial confirmation proceeding, a gifted and talented lawyer. I said to them you have been speaking to people in this area and what can you tell me. He said, well, I'll tell you later after I have an opportunity. I'm not going to make any statement.

Mr. Taylor, does OTS need additional flexibility to deal with the problems such as OTS qualified thrift to lender and mortgages? Do they need additional for the loan to one borrower? Do they need additional for the junk bond legislation, which we passed, the Congress, because we were so interested in, oh, junk bonds are bad and get rid of them. So you make everybody get rid of them with a constrained period of time, you force the market down, and you hurt some that could make it.

I would like to know, and we could go over other issues, too, supervisory good will where we took a perfectly sound good, well managed bank and induced them to take over banks that were failing and now say well, you don't meet this situation.

So what do we do? We put them on the endangered species list, and as soon as we do that we are in trouble, and we cost the taxpayers billions of dollars.

I would like to know when and if you're going to come forward to suggest or put forward an area where OTS may need additional flexibility?

Mr. TAYLOR. Senator, I think that with respect certainly to the single borrower limit, and certainly with respect to the ability of a particular institution to meet its capital requirement, I think OTS has flexibility and is working to try to utilize that flexibility rationally.

Senator D'AMATO. On the loan to one borrower?

Mr. TAYLOR. As far as a phase in goes.

Senator D'AMATO. For how long? I mean I've been hearing this thing now for weeks and months. How long? I think that is nonsense, but go ahead. That is one example. How long? Why push people with good projects, bona fide projects, take builders and put them into bankruptcy? Why force banks to have bad loans that otherwise would be good loans? When is that flexibility going to come out? How long does it take to come up with that solution? That's just one of them.

Mr. TAYLOR. Well, Senator, I certainly concur that if you have a savings institution or a bank with a risk profile that is reasonable and contained and indeed it has an embedded loss and it needs time to repair itself, that indeed it's not increasing its risk and indeed it can demonstrate that it's making progress, that all the flexibility that is available to you ought to be used not solely so as to treat that institution correctly, but so as to minimize the cost to the taxpayer.

Senator D'AMATO. Exactly, to protect the taxpayer. But, you see, you understand that we run the risk, and I think the regulators understand that, that if they make some of these judgments, and in some cases they may be right and there may be cases where it doesn't turn out the way they hoped, and therefore it you just cut off and chop off their head because you don't meet a particular arbitrary limit that has been set by the Congress, right, that's a pretty easy way to function. So we chop off everybody's head, but we cost taxpayers billions of dollars in lost revenues.

Mr. TAYLOR. I think at this point the OTS does not need a change in legislation. What they need to do, which is so difficult, which we all need to do, which is so difficult, is to make the judgments correctly. It is not always clear which judgments are to be made. They are difficult judgments involving a whole raft of factors, and hopefully they will make those judgments correctly, but I think they have the flexibility.

Senator D'AMATO. Secretary Kemp, do you want to add anything to that? I have heard one institution after another tell me that they have been imperiled as a result of this, builders and developers, just as one example that we put up, and that is going to result, and I don't care about them, but in the taxpayers eventually having to take over a situation that could be salvaged where you do have sound management.

Secretary KEMP. There is no doubt that there were unintended consequences of the FIRREA legislation that you have addressed, and frankly Mr. Taylor and Secretary Brady have addressed, and I think it behooves all of us to get busy and recognize the overall consequence of what FIRREA and what tax rates and interest rates, as the Secretary testified to, have negatively on the overall real estate market. So you are properly bringing up a problem that has existed. When the value of assets that go into receivership or conservatorship continue to fall, it calls for immediate action, and I addressed this issue a little bit earlier, Senator D'Amato, when I suggested, as several of us have, that we ought to revisit some of those negative or unintended consequences not only of FIRREA, but the 1986 Tax Reform Act which took the capitals gains rate to the highest effective marginal rate in the century, and the failure to pass the cut in the rate has also impacted negatively on the value of all capital assets.

Senator D'AMATO. Well, I'm just concerned, Mr. Chairman, that by our action in passing FIRREA that we have taken away the ability of regulators to make the kinds of sound choices, and we have placed them in the position where they may very rightfully be saying I would like to be able to make a change, but I can't because the legislation precludes it.

Mr. Chairman, I know the little red light has gone on, but I would like to just raise one issue, and I'm not going to ask for any response, although my friend, Mr. Greenspan is here.

When we read the headlines today, and these are just some of the clippings, about the FDIC being imperiled, et cetera, or not being imperiled, but with a deficit of $851 million in 1989 and the ratios being lower than they have been for quite a bit of time, it raises a question to this Senator's mind as it relates to the value of deposits.

Heretofore historically there has been a value placed on deposits of anywhere from a premium of 5 to 7 percent. So that if an institution were going to sell, et cetera, that was some barometer. Recognizing that some of those deposits may not be those with a good and sound base, that premium may vary somewhat.

But I have received a number of inquiries, and I'm going to ask that we look into this because it seems to me that when an institution, and I'm talking about Seaman's Saving Bank, sells its deposits, which are valued at $2 billion, and they get something like $5 million, not 5 percent and not 4 percent and not 3 percent, but something in the nature of one-quarter of 1 percent. Now that falls within FDIC, but I have to tell you, now we're talking about something more than a fire sale. We're talking about $2 billion worth of deposits, and I don't care if a billion of those leave tomorrow.

Certainly it would seem to me that a sale for $5 million rightfully has raised some questions as to how is that sale conducted, what manner was it open to others, and I have heard others tell me in the savings area that they didn't get an opportunity to come in and to bid on that. So it's something that I don't know if any of the panelists want to comment, Mr. Chairman, but I certainly think we should look into that.

The CHAIRMAN. Let me raise a couple of other things here.

Secretary Brady, Mr. Taylor just said a minute ago in response to Senator D'Amato that he did not think we needed any changes in the legislation, at least not at this time. Now obviously the money question is a different story. You are here indicating you're going to need more money, but do I take it that you're view is the same as Mr. Taylor's, that you are not asking us to go in and open up the legislation for other substantive changes to that legislation at this time; is that right?

Secretary BRADY. That's correct, we are not asking for a change in the legislation, Chairman Riegle. It has been on the books less than 10 months now, and we've got plenty of work to do making the system work as it is.

I would only say, as I said in my testimony, the RTC has already grown bigger than the Citicorp in 10 months, and that's a plenty big digestion problem. We've got plenty to do.

The CHAIRMAN. But I take it that also means you feel that you have what you need to work with within the structure of the legislation in carrying out this assignment; is that right?

Secretary BRADY. That's right, excepting the money question, which you talked about.

The CHAIRMAN. Very good.

Chairman Greenspan, I think we need to ask you to respond to a couple of things here. What I am gathering from what I have heard this morning is that we are going to need I think conservatively another $50 billion in addition to the $50 billion that we provided in the original bill to deal with losses as they go forward in time.

It looks to me like that that figure is going to at a minimum double, and, in fact, it may end up being closer to $150 billion. I hope not.

In addition to that, we have got a working capital request that is going to be I gather at least $50 billion and probably more than that. We have not yet pinned that down with precision.

These are big amounts of money, and I am concerned about the impact in the credit markets. I am interested in your impression as to the impact of these additional financial needs on interest rates as they make their way into the credit system.

You've heard comments from others this morning that there is a lot of anecdotal information that would suggest that we have got some kind of a credit crunch going on. Now maybe it is confined principally to real estate or maybe to smaller borrowers, but that is the impression that is rather widespread.

I'm asking you now for your sense, for the degree to which these additional financial needs either are or are likely to affect our credit situation in the country as a whole and have some effect on interest rates.

Chairman **Greenspan**. Well, as you can well imagine, Mr. Chairman, we at the Federal Reserve have given very considerable thought to precisely these questions because a great deal is at stake.

The theoretical issues are very difficult to get your hands on, but let me see if I can summarize them in a fairly understandable way.

The types of borrowing that go on with respect to the borrowing, the type of REVCORP that we have been looking at, is the type of borrowing which does not significantly alter the balance of supply and demand for savings and investment, and in and of itself it should not have any measurable impact on interest rates.

There are, however, other aspects of this process which do affect interest rates, but let me continue on this for a minute. The best way I think of looking at this is to try to think of what the closest analogy we have in the current markets is, and that relates to a large extent to the type of borrowing that goes on with respect to Fannie Mae, Freddie Mac and Ginnie Mae.

They raise funds in the market to purchase mortgages. The mortgages they buy are good mortgages, and the impact that that process has on interest rates is apparently, as best we can judge, not on the level of rates, but basically on the yield spread between mortgages on the one hand and U.S. Treasury on the other.

The more those types of purchases are made with borrowed U.S. Treasury or U.S. Treasury guaranteed funds, or however you want to define it, the narrower the spread between interest rates on primary mortgages and on U.S. Treasury. The level of interest rates though, as I said, is not affected.

Consider now the hypothetical case where a Government agency were to, for example, raise $50 billion and buy $50 billion worth of good mortgages, and then found later that the mortgages all defaulted and, indeed, turned out to be worthless. You do not have an interest rates effect in that particular context. In other words, nobody's actions in the private sector or any individuals operating would essentially be changed because of that fact.

There is, however, an element in this type of financing which does affect interest rates, and this is type of issue which relates to why it is that when we borrow to fund the Defense Department or other agencies which buy goods and services it does have an interest rates effect, because the supply of savings and investment is being altered.

The interest that is paid on REVCORP paper and the interest that is paid on all related type of issues tends to have any effect which is similar to the issuance of bonds to finance the Defense Department. In other words, you do affect the consumption expenditures in the society, the savings and the investment and, hence, there is an interest rate effect on the sale of these bonds, but not because of the sale, but because the net interest receipts in the household sector, for example, as a consequence of all of these transactions, goes up, and to the extent that those interest income receipts are used to purchase goods and services and, as best we can judge, the so-called marginal propensity to consume is about .75, it affects savings and it affects investment and therefore raises interest rates.

However, it is a wholly different order of magnitude then when we are raising funds to finance let's say the Defense Department purchases of goods and services directly or through transfer payments, Social Security payments and the like, affect consumption expenditures. That affects interest rates directly and immediately, but the overall net effect of these types of issues is a small fraction of that.

I'm not saying it has not effect, it does, but I'm saying that the order of magnitude, as best that one can line up the issue, is very moderate in nature and not one that creates as yet any grave concern.

The CHAIRMAN. Well, it may not as yet, and I am very much interested in what the effect is likely to be in 6 months or 9 months or 12 months because I'm concerned about the future effect.

Are you convinced that we are in a credit crunch now, or do we have some kind of a credit crunch going on?

Chairman GREENSPAN. I think that what is clear at this moment is that there is some slowing in credit extensions. I mean it's fairly obvious that a substantial part, and in fact the majority of the effect results in a weakening in the real estate market and a declining demand for real estate credit.

Nonetheless, there is no question, at least in my mind, that there is some precautionary pulling back on the part of some commercial banks. If that is not the case, human nature has changed, and I wouldn't want to bet on that, because clearly there has been an extraordinary extension of real estate credit over the years. A lot of those loans have ended up as non-performing loans, and it's normal for somebody who has been involved in that process to be pulling back. Part of it is healthy, and we should be supportive of it.

The part which I think would not be healthy, and the part that would concern me is if there is an overreaction and, indeed, a reaction which in fact deprives credit availability for sound, prudent type of investment opportunities of which there clearly are a very large number.

The CHAIRMAN. Are we seeing any of that?

Chairman GREENSPAN. It's very difficult to say. I would suspect there is some of it, but I must tell you that the evidence is so ephemeral in this regard that I wouldn't want to venture forth an opinion.

I would say this, however, Mr. Chairman, we are looking at this issue very closely. We are trying to get a week by week evaluation of the balance sheets of the commercial banking sector and the thrift system with the fragmentary data that we have and try to keep a very close monitoring of the process as it unfolds.

The CHAIRMAN. Now, apart from real estate lending where you say there is a contraction going on and some of it appears to be what one might expect given all of the other circumstances, we are hearing more and more information of contraction of small business lending. Are you seeing any of that?

Chairman Greenspan. Well, it's an interesting problem because the various surveys of small business, including the National Federation of Independent Businessmen, does not as of the end of March show any of that particular problem outside of New England where it is a clear and quite identifiable problem, but it is very difficult to find evidences of this.

However, the anecdotal evidence is so extraordinarily large that my view is that what the anecdotal evidence is focusing on, for which we have as yet no useful data, is perhaps a decline in commitments. And if the commitments are being pulled in, we will not see that in the actual banking loan data for quite a long while. I suspect on the basis of what we can judge as of this moment that there is some of that going on.

The Chairman. Shouldn't we ask? I mean it seems to me that if there is a kind of drying up of credit for small business and it's a withdrawing of commitments where there is a lag before we see it in our data that a survey ought to be done. The Fed ought to do one so that we don't wait for the data to come in and risk sliding into a recession, but we go out and get the data now.

Chairman Greenspan. Well, we are obviously looking at exactly that issue and are trying to get a sense of it. I must tell you, however, that there is no evidence that I am aware of, and we audit this on a day-by-day basis, that we are seeing an economic effect, in other words, that there is a significant measurable effect on economic activity. There is, as far as I can see, no evidence of that.

The Chairman. As yet.

Chairman Greenspan. Yes, exactly. I think our concern has not got to be about what is happening now, but to make certain that what is emerging here is contained and basically does not go to the point where it has negative aspects on the economy.

So let me emphasize it's at the stage where I think our actions are and should continue to be precautionary. I think that it's important to know what we are looking at and to be as clear as we possibly can to understand what the anecdotal evidence is telling us and not overreact to it, but also not disregard it.

The Chairman. I want to ask one more question and then I want to relate it to the job that the Board has in disposing of assets.

Now the Federal Reserve Board can maintain interest rates and money supply essentially where it is and not tighten by lifting interest rates, but if you have a credit contraction going on, you can have a slowing down of the economy even though interest rates, at least on a nominal level, have not increased.

Chairman Greenspan. That's correct, Mr. Chairman.

The Chairman. So if we are used to watching interest rates as the way of determining whether or not we're expanding or contracting the economy, in a situation where some other kind of contraction going on in the credit system, we would have to look beyond interest rates to see it. And we would find a way to anticipate it so that we didn't wake up 6 months later and find out we had a problem on our hands that we really wouldn't have intended and wouldn't have wanted to come about if there was reasonable way to prevent it.

Chairman **Greenspan**. Oh, I think that's the best way of describing why it is that we are extending so much effort to make certain we can get our hands around this as best we can.

The **Chairman**. Now, Mr. Larson, let me ask you this. You are now a part of the Board here and you've got a big job of disposing of assets. We've got an auction coming up, which I want you to talk about in a second, but it seems to me we are in a situation where suddenly the public owning a large number of assets that have been taken in for failed thrifts is in a position of having to try to sell the assets into a market that is otherwise awfully depressed right now. In other words, we are seeing less lending going into real estate, we are seeing an oversupply of real estate on the market, we are seeing prices being driven down. I don't just think it's in a few areas of the country from what I can see. It's not universal, but it's in a lot of areas of the country.

If we are in that kind of a set of economic dynamics, and you and the other Board members are nevertheless wanting to try to move the real estate out and get it into the hands of new owners who will maintain it and to stop the losses that are associated with holding properties, it would seem to me that you are being confronted by market conditions that are almost the very kind you would least like to see.

Isn't it much tougher to sell into that kind of a market with whatever the market arrangements than if you had a situation where there was not a credit crunch and things were more buoyant and people were more interested in making investments?

Mr. **Larson**. I think that is an appropriate characterization, Mr. Chairman, although I think it is useful to remember that real estate especially is very situation specific. It is not a single industry. It is a group of industries. There is very little other than a common use of land between many commercial types of real estate activity, for instance, and home building, and in the RTC portfolio there is a wide variety of real estate assets.

So that I think we have to be careful not to overgeneralize about either the state of the economy as it relates to real estate or the interaction between the disposition activity of specific assets and the market receptivity and therefore pricing for them.

Having said that, there is no question that the economic environment under which this disposition activity is going forward is less than ideal. It continues to be my view based on the information that I have seen that notwithstanding this environment, disposition is preferable to an effort to hold and continue to manage and in all likelihood I believe in most cases at least incur further deterioration in the market value of the properties.

But how that real estate is marketed, the manner in which it is moved to the marketplace I think can make a material difference, and frankly, as I indicated earlier in my testimony, the manner in which we and you and a number of other people whose views and comments and observations and perspectives influence the psychology of the market act can I think also make a material difference in terms of the potential value realization.

The **Chairman**. Tell us about this auction that is coming up and what is planned and when do we expect to see that accomplish?

Mr. **Larson**. I would like to defer to Mr. Taylor in terms of the specifics of that, Mr. Chairman, but before doing so, I would like to emphasize that when the RTC or for that matter those of us on the Oversight Board talk about auctions, we are talking as much, I think, about process as we are a particular event, and it seems to me that it's useful to keep in mind that the auction process has many variations and permutations and that we're going to be encouraging the RTC to explore all of them, and only one version of that is a place under a tent with an auctioneer and a specific set of parameters.

The **Chairman**. I think that is an important clarification.

Mr. Taylor, where do we stand either with this rather publicized upcoming auction or the broader question of asset disposition? What are we doing and what do you foresee?

Mr. **Taylor**. Well, as far as the auction is concerned, the RTC is really doing the planning and basically is taking a group of sizeable properties and doing a lot of prequalification to bidders and assembling as many bidders as can be assembled in a hook-up for the auction. So it's not simply just dragging buildings out and seeing how many people show up. It's really, from what I have seen so far, pretty well planned.

The **Chairman**. Who is in charge of that, by the way? I mean is there somebody that has been given that assignment specifically within your organization?

Mr. **Taylor**. Well, actually Lamar Kelly is the fellow at the RTC who is responsible for all asset disposition. So responsibility for the auction would run to him.

As far as the asset disposition, probably one of the key factors in all this is that the bulk of the assets are not real estate. I mean you still have to wrestle the borrower to get the real estate. The bulk of the difficult properties, the difficult assets to sell are loans, loans secured by real estate and in various states of construction, repair, title and so forth, and that makes it difficult.

I would point out and I think in all of this we all get very impatient because we want it sold right away, but I would point out that since FIRREA passed, the RTC has liquidated over $42 billion worth of assets out of these conservatorship thrifts.

Now, granted, a good share of some of those represent repayments of loans in the normal course and some of them represent asset sales. The bulk really represent the sale of securities, and indeed you could say the easier assets to sell. But when you are talking about a $42 billion liquidation in a period of 9 months, that's certainly respectable.

The **Chairman**. And what is left. I mean what do you have on hand right now that is sort of in the cat and dog category that are much harder to sell?

Mr. **Taylor**. Well, I think first is the raw land, second are interests in various servicing corporations and various subsidiaries which really represent development projects. There is some difficulty in the non-mortgage loans. There are some commercial loans that were made, and those are difficult.

I think if you were to make a very, very rough cut, you would take the assets that are in conservatorship presently, which I think is about $160 billion, divide that very roughly in half and you could then say half of those $160 billion, assets are really definable, understandable, marketable once packaged types of assets where you might have a pricing loss as a result of interest rate changes, but basically we feel they are pretty collectable. For example, $52 billion worth of single family or one to four-family mortgage loans which have maybe a 1 percent pass-through rate. Those are pretty recognized assets.

You add to that the installment loans and the securities and so forth, and you roughly equal half, and probably a little more than half that you can liquidate really without any impact on any market. All you are doing is changing the ownership of that financial instrument from the FDIC RTC into the hands of a private holder and there is really no effect on markets.

The other roughly 40 to 50 percent of the assets are more problematic. I mean they represent these more complex types of properties, more complex types of loans and more complex types of investment.

So I really think it's important when you look at these numbers and you try to do these estimates to try and separate these two categories of assets.

The CHAIRMAN. Can we do this. Mr. Secretary, in the interest of time, I think the committee needs to understand this part of the problem better. I don't know that we ought to take the time here now in this setting with all of the rest of you here to do it.

I would like to ask if Mr. Taylor accompanied by whoever else, could come back soon on just this issue to help us understand better the asset disposition process, the inventory, what the experience has been, what is coming in and how does it break down by category. I think we really need to have a much clearer sense of the nature of that asset problem and what is involved in the disposition activities.

So could we have an understanding that we not pursue that at greater length today, but that we will have him come back within a matter of 30 days or so to review that, or anybody else you want to send in on that subject?

Secretary BRADY. That would be fine. I think it is important and we probably should bring someone from the RTC with us, because that is where the merchandise is and that is where the programs are.

The CHAIRMAN. And I may say, too, I think not only does the committee have an oversight obligation to understand the dynamics of that and to try to help you through that job, but I think the public has a keen interest in this and has a very difficult time figuring it out.

I mean we've got these two books that have been formulated of real estate properties, commercial properties and residential properties, a very good listing, although I assume that is out of date because you are obviously taking in more all the time. So with the understanding that we do that, let us leave that point.

Let me just raise a couple of other things.

In your request today, Secretary Brady, for additional funding, and I understand it, and we want to work with you to find the amount and manner in which it is done and so forth, it seems to me the administration is proposing two different options.

One is in effect a discrete amount of money that would be requested that would run for some period of time and then if that proves not to be sufficient, then there would have to be a further request for whatever else is needed, and the other option that is suggested is an open authorization, a blank check approach with the thought in mind that whatever it costs, then the money will be there when it's needed.

First of all, am I interpreting correctly the two methods that you have considered?

Secretary BRADY. Yes.

The CHAIRMAN. My view would be, and I can't speak for the whole committee on this, but I think there probably would be a great unease about the notion of going the blank check route. Now that's not to argue all the merits one way or the other on that question, but I think we are much more likely to see, and I think the committee would want to authorize an amount of money that you reasonably think is the amount that you need from today's revised vantage point to finish the job, and the hope would be that we wouldn't have to revisit it again. But as you say, there are a lot of uncertainties.

Secretary BRADY. Senator Riegle, a blank check may be the right way to do it, whether it's an open authorization or a specific amount.

I think a couple of points are worth making. One, is that in my opinion it won't change the problem or the solution to it. It's entirely acceptable to us to do it either way that the Congress sees fit of course. The pros and cons are simply, one, we are not going to get a precise figure answer as to how much we need, because it's totally a function of what the real estate market is.

If we go to the point where we are authorizing and requesting specific amounts, all we know is that if you do that in the way of a series of payments, you're going to have to change them.

So with that in mind, we will just have to work it out, but I understand your sentiments on that subject.

The CHAIRMAN. Now with respect to the budgeting side of it, let me just express my own view, and I would be interested in what view you may want to express here today. I think we ought to treat these expenditures on budget, but I certainly think they ought to be exempt from the Gramm-Rudman sequester type of requirements. This is just my view and other people have different views.

But related to that, it seems to me that we ought to try to finance these costs directly, in other words, not pay a financing premium by using a financing mechanism that costs more in terms of the credit costs than the cheapist alternative.

Now we have hashed that out before, but that involved earlier spending. Do you have a view on that today? I'm wondering if on those points there might be some consensus. In order to get this done and keep the costs down we ought to try to finance it directly from the Government and treat it on budget, but outside of Gramm-Rudman. Does that seem like a reasonable approach to you?

Secretary BRADY. If I may, may I reply to your second question first, which is that they ought to be done on budget. The previous suggestion that it be done off budget was to put the costs where the problem was in the S&L industry, and there isn't any more money in the S&L industry to do that. We have exhausted those sources. So I think there is only one place to go, which is to take it out of the general Treasury funds.

With regard certainly to Gramm-Rudman, my comments earlier, Senator Riegle, pretty much stand. I think this is going to be part of the budget discussions, and I would prefer to just leave my sentiments where they were before. It can be done both ways. If you are dealing with kind of a polar estimate with regarding to working capital and stuff like that, you're never going to be able to get to a single budget figure. So I think that that question will answer itself during the budget negotiations.

The CHAIRMAN. In terms of financing this additional amount that we are now obviously going to need shouldn't we just finance that directly? I mean shouldn't the Treasury do it and keep the cost down?

Secretary BRADY. Sure.

The CHAIRMAN. In terms of the working capital number, what is your best estimate at the moment in terms of what we are going to need for working capital and over what time period?

Secretary BRADY. Well, I'm going to have to get my numbers out again here.

The CHAIRMAN. We didn't really cover that before. We kind of moved around through a lot of issues, but I think we would be remiss if we didn't pin down the working capital issue here this morning.

Secretary BRADY. Well, as we said earlier, the total range for the whole problem ranged between $89 billion and $132 billion less whatever amount that has been expended already, which we say is $73 billion. With regard to the working capital component, of the total figure, I believe—let me just check and see. The figure that we have been using in the budget negotiations is somewhere—we've had a wide range because everybody wanted to know what if this and what if that—but I think the figure of $14 billion to $27 billion during the fiscal year 1991 is probably a guess that is not too far off the mark with regard to 1991.

After that, Senator Riegle, it depends on the pace of resolutions and the speed with which things are done because all of the working capital money, if we are right about the fact that it's working capital, comes back out again, and in fact it could go the other way. You could have a plus to the budget, and that of course is part of the problem that the Budget Committee is dealing with, which is some years it will be up and others it will be down.

The CHAIRMAN. Well, I hope somebody will take a very close look at that because, I think we want to be as accurate as possible on that working capital estimate and not get a surprise later on down the line.

I want to thank all of you for your testimony today. We are going to have questions for the record. May I ask that, because this is a semiannual report, we will get the questions to you promptly, and I would like to try to have a week to 2-week turnaround on the questions, if at all possible, so we can get the committee report printed. So could we try to abide by that?

Secretary BRADY. We will do our best.

The **Chairman**. Very good. Thank you all.

The committee stands in recess.

[The committee adjourned at 1:40 p.m., subject to the call of the Chair.]

[Response to written questions follow:]

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

ALAN GREENSPAN
CHAIRMAN

June 29, 1990

The Honorable Donald W. Riegle, Jr.
Chairman
Committee on Banking, Housing, and
Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

Thank you for your letter of May 30 in which you transmitted six questions from Senator Roth for the record of the hearing on May 23 on the Resolution Trust Corporation.

Since Questions 1-4 and Question 6 relate to matters common to each member of the Resolution Trust Corporation Oversight Board, responses to these questions will be provided separately. I am enclosing my response to Question 5.

Please let me know if I can be of further assistance.

Sincerely,

Enclosure

Chairman Greenspan subsequently submitted the following in response to a written question from Senator Roth in connection with the hearing held on May 23, 1990.

Q.5. Chairman Greenspan, your commitment to bringing down inflation is clear. But would lower inflation exacerbate the decline in real estate prices? If it would, then does the goal of lower inflation conflict with the goal of selling RTC real estate at the highest possible price? How do you reconcile the conflict?

A.5. It is possible, as you suggest, that lower inflation rates could continue to lower real estate prices--or at least result in a slower rate of increase. A sharp adjustment of prices is not likely, however, as we envision only a gradual measured reduction in inflation. Moreover, lower inflation would also bring with it an important benefit to both the RTC and the American public--lower interest rates. Interest rates incorporate a premium for the expected erosion of purchasing power over the term of any loan--and this premium probably climbs disproportionately as inflation increases because higher inflation rates are more variable and uncertain. At lower inflation rates, the borrowing costs of the RTC as well as of the private parties buying its assets would be reduced. Moreover, the decreases in inflation and interest rates would be of considerable assistance to existing thrifts, many of which still fund long-term assets with short-term debt, holding down the increases in the caseload of the RTC. Finally, and most importantly, lower inflation will promote a stable economic environment and continued economic growth, facilitating the sale of assets by the RTC and benefitting the public more generally.

OVERSIGHT BOARD
RESOLUTION TRUST CORPORATION
Washington, D.C. 20232

July 31, 1990

The Honorable Donald W. Riegle, Jr.
Chairman
Committee on Banking, Housing, and
Urban Affairs
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

Enclosed you will find responses to the questions for the Oversight Board following the May 23 hearing of the Committee on Banking, Housing, and Urban Affairs.

I hope the Committee finds this information responsive to its concerns.

Sincerely,

Peter H. Monroe
President

Enclosure

Questions submitted by Senator Roth
to the Oversight Board

Q.1 Have you gone to institutional investors and money managers to find out what they are interested in buying? Have you asked them on what terms they would make a market for RTC assets?

A.1 The RTC has not solicited institutional investors directly, but the feedback from the broker-dealer community indicates that they are interested in RTC securities. In addition, some institutional investors have called the RTC directly. For the most part the RTC is relying on the broker-dealer community, which is making the market, to ferret out institutional investor interest and channel that back to the RTC. This has resulted in very aggressive bidding on most RTC securities.

Q.2 If your current sales plan of "flexible" reductions fails to attract an adequate response, what will you do? Is there anyone at the RTC or the Oversight Board who is charged with formulating the next strategy? If so, who?

A.2 The Board of Directors of the RTC has revised its policy for determining the market value of assets to permit reductions of up to 20 percent from appraised value. The first revision will be allowed after the asset has been actively marketed for at least 6 months (4 months for single family homes). Subsequent revision would require at least three months of additional marketing. The RTC believes this policy will sufficiently accelerate the sale of property so as to reduce its inventory. Should this not be the case, the RTC's Asset and Real Estate Management Division would be responsible for writing new procedures for determining market value of assets. The Oversight Board will monitor progress under the revised procedures, develop alternative policy guidance as needed, and review any new operating policies and procedures developed by the RTC.

Q.3 Is there enough credit available today for purchasers to acquire billions of dollars in RTC assets?

A.3 Credit availability should not be a problem for disposal of RTC assets. From the perspective of the entire economy, purchases and sales of existing properties and financial assets do not "use up" credit, in the sense of placing a call on our scarce pool of private savings. As assets are sold by the RTC, funds received by the RTC will be returned to the financial markets either through repayment of working capital borrowed by the Treasury or through the purchase by the RTC of further thrift assets. These funds then are available to private borrowers acquiring RTC assets. Credit flows will be redirected, but the total volume will be little changed. To be sure, in that process individual borrowers will have to face the usual scrutiny related to the value of collateral and the ability to repay, and, depending on their circumstances, particular borrowers could face constraints on credit availability. But, in the aggregate, there should be ample funds to finance purchases of RTC assets by creditworthy borrowers.

Q.4 Does not the announcement that the asking price of the RTC assets may well diminish over the next few months make immediate sales less likely? Does the market psychology of a Filene's basement sale or Syms merchandising really apply to RTC asset sales?

A.4 When a prospective buyer contemplates the purchase of any property, he or she will almost always inquire how long the property has been on the market. If the property has not sold for four to six months, the buyer will expect the price to be discounted. It is possible that some potential buyers of RTC property will, in light of the new policy, gamble that if they wait, the property will be discounted. They may, however, lose the property as a result. Further, they do not know how much of a discount will be available.

The purpose of lowering the price is to find the market value. If properties were appraised too high, they would probably not have sold at the appraised value. Persons buying property at a reduced price -- relative to the appraised value -- are buying it at the market price, not necessarily at bargain prices.

Q.6 Do you (Chairman Greenspan/Secretary Brady) believe that it was wise for Congress to enact a stricter QTL test as part of FIRREA? When the RTC offers a thrift for sale, does not the presence of the QTL test serve to chill prospective purchasers? I recall that the Administration's bill did not contain such a QTL test. Would you support enactment of S. 2311, a bill (a copy of which is attached) I have introduced to modify the QTL test?

A.6 No, we do not believe that it was wise to tighten the QTL test as part of FIRREA. We are concerned that depository institutions that specialize in home mortgage lending remain exposed to excessive interest rate risk until we reestablish an environment of low and stable inflation. However, we would not support loosening the QTL test at this time. We are not aware of any evidence that the QTL test has been a significant impediment to RTC's efforts to sell thrifts. Many potential purchasers intend to operate the institutions as traditional thrifts that would meet the QTL test. Those that don't intend to operate the institution as a thrift have the option of converting to a commercial bank charter.

Questions of Senator Alan Cranston
to the Oversight Board

Q.1 How much of the RTC's funding has been used to pay off advances from the Federal Home Loan Banks held by thrifts?

A.1. The cumulative total, from August 18, 1989 to June 18, 1990, is $6.2 billion. The quarterly figures are as follows: 8/18/89 - 12/31/89: $2.96 billion; 1/1/90 - 3/31/90: $1.63 billion; 4/1/90 - 5/28/90: $236 million; 6/1/90 - 6/18/90: $1.38 billion.

Q.2 Funds used for advances are off budget and have no effect on the deficit. In light of the limitation on funds available for working capital and for case resolutions, would you explain why the RTC is using its funds to pay down advances from the Federal Home Loan Banks instead of conserving those funds for more urgent needs?

A.2 The determination to initiate the replacement of high-cost funds in insolvent thrifts was based on the view that this would contribute towards stemming immediately the growth in losses of current conservatorships as well as thrifts likely to be placed in conservatorship. The RTC estimated that conservatorships were experiencing combined operating losses approaching $14 million per day as of January 1990. Approximately 20 percent of the loss was attributable to the fact that these institutions must pay significantly higher rates for their funding than healthier competitors. This could be rapidly eliminated through high-cost funds replacement.

Oversight Board policy states that the RTC's first priority is case resolution. To the extent funds available to the RTC are not employed for first priority cases, they may be used to replace FHLB advances with lower cost funds. In its past two quarterly budget plans, the RTC has requested significant amounts of funding to pay down advances, and other high cost funds, and has been denied its request by the Oversight Board because funds are needed for case resolutions.

Q.3 The RTC holds various types of securitized assets such as Fannie Maes, Ginnie Maes and FHA guaranteed paper. Potential buyers in order to locate these assets to bid must deal with each office where they are located, 4 regional offices, Washington's office and others. This process is discouraging to buyers. When will the capital markets desk that is intended to centralize this activity be set up.

A.3 Any qualified buyer of financial assets -- mortgage-backed or asset-backed securities, U.S. Treasury and agencies, interest rate swaps, high grade and low grade corporate bonds, etc. -- need only identify themselves to the RTC's Capital Markets Branch in Washington. Their responsibility is to orchestrate the method and timing of sales, matching potential bidders of specific assets with conservatorships or receiverships selling like or similar assets. Therefore, while a relationship often exists between potential bidders and the institutions or RTC regions, they are not necessary. One need only contact Washington, D.C. The Capital Markets Desk to which you refer is in the process of being expanded, with one staff member already on board.

Q.4 Would you indicate the size of your junk bond portfolio?

a. How are you managing the portfolio? Will there be any major sales anytime soon.

A.4 The RTC has indicated that its junk bond portfolio approximates $4 billion in face value.

a. The RTC intends to secure a financial advisor to assist in the disposition process. In the meantime it has sold, and will continue to sell securities as opportunities arise.

Q.5 The Street (Wall Street) had been pretty jittery about this portfolio until the RTC announced that there would be no "dumping". If there are sales, will they be in small lots, big lots or structured CBO transactions (collateral obligation transactions)?

A.5 If you mean the RTC's "junk bond" portfolio when you refer to "this portfolio", the RTC will sell in whatever lots or structures enable it to achieve maximum value.

Q.6 Many of the junk bonds are in default. Has the RTC been active in pursuing its legal rights with credit committees, in bankruptcy courts and other default situations to recoup some of the money on this portfolio. Are you (RTC) represented on any credit committees?

A.6 As a major holder of junk bonds, the RTC through its conservatorships, either directly or through its outside advisors, is active not only on those issues currently in default but also where opportunities exist for bond holders to be held on proposed exchange offers and other types of debt restructuring. Given the fact that junk bond holdings are currently being serviced this way, the RTC does not sit on any committees but stands ready to do so if necessary to maximize value.

Q.7 In FIRREA we established two affordable housing programs one involving a set-aside from bank retained earnings, and one not involving a set-aside.

a. What progress has been made in implementing the Community Investment program? When can we expect non-profit groups and local governments to receive funds from the affordable housing programs?

A.7 The Community Investment and Affordable Housing Programs were established to expand the Federal Home Loan Banks' role in the provision of affordable housing. Implementation of these programs is the direct and primary responsibility of the Federal Housing Finance Board (FHFB). The Oversight Board has no direct involvement or oversight responsibilities over either of these programs.

In response to our inquiry to the FHFB regarding the status of the Community Investment Program, they asked that you contact the Deputy Director of the Office of Housing Finance Programs for further information.

On March 1, 1990, the FHFB announced the adoption of interim final regulations for the operation of the Affordable Housing Program (AHP) by the Federal Home Loan Banks. The comment period on these regulations closed May 1. We are advised by the FHFB that in order not to delay the first round of funding, until final regulations are issued, the interim regulations will be in effect.

According to the Federal Housing Finance Board, the $78 million program will have two semiannual District-wide competitions for the funding. The first round of AHP awards was announced on July 17. A total of $47.2 million in AHP funds was made available. Applications for the final 1990 AHP funding are to be made between July 15 and August 31. Only institutions affiliated with the Federal Home Loan Banks are eligible to apply for Affordable Housing Funds.

For further information on this program you may contact the FHFB Office of Housing Finance Programs.

Q.8 In FIRREA we were mindful that a significant part of the business of reforming and strengthening the thrift industry would involve outside contractors. We included specific provisions to require that minorities and women be sought after and included in the contracting process.

a. How many of the contracting and subcontracting firms that you have contracted with thus far have been minority or female owned?

A.8 The RTC is just beginning to track, on a national basis, the number of minority or female owned contracting and subcontracting firms. Based on preliminary data from the first quarter of calendar year 1990, approximately 206, or 15 percent, of the 1,411 contracts awarded by the RTC receiverships have been to minority- and women-owned businesses. These contracts represent about $3.9 million of the approximately $25.3 million in total estimated contracting fees.

Q.9 What efforts are being made to ensure that non-minority owned firms that you contract with employ minorities and women.

A.9 Contractors that do business with the RTC have mandatory subcontracting requirements. In the process of subcontracting, they will have to go through the same selection and engagement process as the RTC does, and consequently address, as does the RTC, the concerns of minority and women outreach. In this process, they would be required to use the RTC's ratio for minority and women-owned firms for the generation of a bidding list.

Questions from Senator Bob Graham
for Secretary Brady

Q.1 Gentlemen, do you have the resources both collectively and individually to handle the problem? If not what does Congress need to do to assist you?

A.1 As stated in our testimony: "It is now clear that the amounts projected and authorized for the RTC in FIRREA will fall short of what is required." We further stated that the cost would range between $90 and $130 billion, compared with the $73 billion provided in FIRREA.

The Oversight Board intends to work with the Congress and the Administration to develop an approach which will provide the RTC the resources necessary to finish the job, while maintaining adequate controls. Given the enormous significance of this issue for the federal budget, we believe that this is a matter which should be considered in the current budget discussions between the Administration and the Congressional leadership.

Q.2 Some of my Florida constituents have been sending me ads illustrating a problem that occurred in 1988. That problem is that RTC assisted institutions are offering interest rates that are substantially ahead of the market. Therefore, imperilling the solvent institutions who have to compete. [sic]

For instance, Centrust, one of the largest institutions to go into conservatorship, and one of the largest thrift institutions in the southeast was offering about 40 basis points higher than the south Florida [a]verge and 50 basis points above the national average. It is clearly a means of attracting depositors to an institution that's been under a lot of stress.

Is this pattern typical of other regions of the country?

A.2 The problem that your question points up does exist in regions other than Florida, but is not a condition created by the savings and loan industry by choice. As these institutions, which are in conservatorship, have liquidity pressures, they must go to the market for funds. They attempt to be competitive, but not the rate leaders -- it is the market that is dictating the high premiums. It is also a fact of the marketplace that distressed institutions must offer higher rates. The RTC has directed thrift institutions under its control to keep maturities at short terms, offer no deposits in excess of the insurance limit, and reduce interest rates as quickly as possible.

Q.3 Mr. Greenspan, I attribute a quote to you at the opening of the Social Security group in 1983 in which you said that there was going to be one standard for the work of that Commission and that was: "Everyone was entitled to their own opinion; nobody was entitled to their own facts." In the savings and loan problem we have a lot of people who have chosen to use their own facts in order to support their own opinions.

During the last week of April we were attempting to get data on the current numbers of institutions in different categories of distress and the deposits in those institutions. We found that there was no consistency between the information provided by the RTC and OTS.

I would hope that one of the contributions that your group might make would be to encourage the establishment of consistent definitions and reporting standards so that there will be a commonality of information.

A.3 We agree with you on the importance of reporting data using consistent definitions and standards. We would, however, note that there should be no discrepancy between the data generated by the OTS and the RTC. Both agencies use the same method of reporting -- the thrift financial report -- for which there is a standard instruction manual. The problem you refer to may have arisen because the institutions you were inquiring about were in different stages of resolution -- receivership, conservatorship, or on the watch list.

Q.4 Impact on Housing:
Have you done any analysis at all on the impact of the housing industry by the FIRREA?

Are you concerned about the lack of construction and development credit by the realtors and homebuilders?

Should Congress do anything about this complaint?

Are there other areas of concern about FIRREA as they relate to the housing industry?

A.4 Under FIRREA, the role of the Oversight Board is to oversee and be accountable for the RTC. To the extent that there are concerns about the impact of FIRREA on the housing industry, the focus would be on regulatory provisions under the jurisdiction of the Office of Thrift Supervision. The Oversight board cannot, as its role is defined by law, be responsible for the interpretation or implementation of thrift industry regulations, including those affecting housing.

The Oversight Board has not conducted any independent analysis of FIRREA's impact on the housing industry or on the availability of credit. We are aware that the application of FIRREA's loans to one borrower limit has raised concerns by home builders and lenders. In response, the Office of Thrift Supervision recently issued a final rule giving those thrifts meeting their fully phased-in capital requirements until December 31, 1991 to make a transition to new rules governing loans to one borrower. Through the end of 1990, healthy thrifts can grant new loans of up to 60 percent of their unimpaired capital and surplus to one borrower for development of domestic residential housing. After December 31, 1990, the limit declines to 30 percent. The 15 percent limit takes effect January 1992.

Question for Philip C. Jackson, Jr.
by Senator Donald W. Riegle, Jr.

Q.1 The RTC's borrowing cap includes a limit based on 85 percent of market value of its property. If the RTC is proposing to mark assets down by 20 percent and 30 percent, are you confident that the borrowing cap limits will be observed?

A.1 Yes, we will observe the limit based on our best estimates of the fair market value of noncash assets, because that limit is statutory. However, the definition issue is a sensitive one because market value is an event in the future. If the borrowing limit is a specified limit of market value of assets at the present, it may be that the market value could change. Future events that might impact on borrowing capacity make the task a difficult one.

Question for Robert C. Larson
by Senator Donald W. Riegle, Jr.

Q.1 Questions have often been raised about the use of financing by the RTC in its marketing efforts. Certain groups have suggested that financing is necessary to sell distressed assets. Others say that providing generous financing can leave the RTC holding the bag if the property deteriorates, while giving up all the upside potential. Is the RTC's current financing policy adequate to move its inventory of assets? Does it present any undue risk to the RTC?

A.1 On March 8, 1990, the Oversight Board adopted a policy on seller financing of real estate assets for a limited amount ($1 billion) permitting the RTC to accept down payments of as low as 15 percent if the loan can be readily sold into the secondary market or if, in the opinion of the RTC, the transaction otherwise will result in the maximization of the net present value return to the RTC.

To date this policy has been used to a very limited extent. Nevertheless, we recognize that there is a growing interest in additional financing assistance as a way to expedite asset sales without further depressing prices. This month the Board also approved a plan allowing the RTC to provide, on a trial basis, financing for up to $2 billion of bulk sales transactions of RTC assets. Assets to be sold include commercial loans, commercial properties, multi-family residential properties, and multi-family residential loans.

The Oversight Board is concerned about not prolonging the government's exposure through extensive seller financing, but will certainly continue to look at the needs of the market and alternative approaches. We need to see how the existing policies work and measure their progress. The Board will evaluate the efficacy of these policy as well as the adequacy of the aggregate loan ceiling after the policies have been given sufficient time to work.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR RIEGLE FROM
ALAN GREENSPAN

Q.1. FIRREA generally applies to thrift institutions the same 15-percent limit on loans to one borrower as applies to national banks. Because the limit is based on "unimpaired capital and unimpaired surplus," it prevents tangibly insolvent thrifts from making new real-estate development (ADC) loans of more than $500,000. Some of these thrifts argue that the limit, by denying such thrifts the high rates of return available on ADC loans, will cause such thrifts to fail and increase the long-term cost to the Government.

a. Would you be concerned that ADC loans by insolvent or weakly capitalized thrifts would tend to be illiquid and of uncertain credit quality?

A.1a. So-called ADC loans are typically characterized by limited equity investment by the developer and heavy reliance on borrowed funds to acquire the property, carry out the development and construction phase, and carry the completed property until it is sold to a permanent user or, if a rental property, until it generates sufficient cash flow to qualify for conventional permanent financing. As such, these loans actually may subject the lender to risks far more characteristic of an equity investor than a secured provider of credit. Furthermore, under generally accepted accounting principles some ADC arrangements must be reported as investments in real estate when the transaction is structured in such a way that the lender can receive more than 50 percent of the expected profits in the form of interest, fees, or other compensation.

In view of these characteristics, ADC loans tend to be more risky than more traditional real estate loans, such as loans secured by existing residential or established commercial properties. The risks associated with ADC loans are compounded by the uncertainties associated with the development process. The success of a project hinges on the developer's ability to correctly understand and predict future market conditions, adequately estimate construction costs, and efficiently plan and oversee the construction process--all with the objective of assuring that the cash flow from the completed property will be sufficient to generate funds to repay the lender and provide a reasonable return to the owner. During the developmental process external factors affecting project costs may change and have a materially negative impact on a project's success. Cost overruns arising from delays in construction can threaten a project's viability, and typically, in these types of loans the borrower has little equity or working capital to offset or absorb cost overruns. Furthermore, since cost overruns generally do not increase the value of a project at completion, they actually increase the lender's risk of loss. The longer it takes to bring a project on-line, the greater the risk that market conditions or other circumstances may change and imperil the project's prospects for success.

When an ADC loan becomes distressed, the lender must decide whether to advance more funds to the original developer, or to foreclose on the original developer and to recruit and finance a new developer to complete the project. Such advances may increase the lender's loan above the project's current collateral value and result in substantial losses. Another alternative is to foreclose on the project and sell it "as is" which may also entail a substantial loss to the lender.

The risks inherent in development lending tend to make such advances far less liquid than, for example, typical single family mortgages. Therefore, it is all the more appropriate that institutions making such loans have sufficient capital strength so that they can carry troubled projects until orderly disposal can be arranged. Case studies from the savings and loan industry add further support to the conclusion that tangibly insolvent or weakly capitalized thrifts do not have sufficient staying power to support sizable portfolio concentrations of development project loans when they become distressed. Such distressed loans coupled with an already weakened capital cushion can quickly erode an institution's solvency and would likely increase the need for and amount of intervention by the government.

b. Would the long-term cost to the Government be higher or lower if tangibly insolvent thrifts could make large ADC loans?

A.1b. Executives representing thinly capitalized thrifts have argued that restricting their ability to make large development loans above $500,000 will increase both thrift failures and the costs to the government of those failures. Their rationale is that they are denied the higher earnings from such loans and impeded from generating capital internally. These arguments tend to downplay the significance of risks in consideration of the risk-reward tradeoff. In particular, ADC loans tend to be more risky than commercial real estate loans, and the higher yields ADC loans initially generate may be more than offset by subsequent losses.

Given the uncertainty relating to the risk-reward tradeoff from making ADC loans as well as the losses that thrifts have incurred on such loans, only organizations with adequate capital cushions could make ADC loans without further increasing the government's potential long-term costs. To the extent that credit quality is compromised for ADC or other loans to gain fee income and higher rates of return, subsequent losses may well exceed the revenue returns. Where such thrifts do not have sufficient capital to absorb these losses, then the thrifts are likely to fail and the government will incur greater losses as the costs to pay depositors and liquidate the assets of the failed thrifts increase.

Q.2. Many homebuilders blame their current difficulties in obtaining credit (and particularly ADC loans) on FIRREA's limit on loans to one borrower. Do those difficulties really stem from that limit? What about other factors, such as the end of aggressive lending by insolvent or undercapitalized thrifts; a trend toward higher credit standards and loan-to-value requirements; the apparent softening of many real estate markets; and the fact that large losses have made banks and thrifts increasingly wary of real estate development loans?

A.2. Limitations on the loans that may be made to a single borrower, such as the 15 percent lending limit imposed on thrifts by FIRREA, are designed to protect depository institutions from concentrations of credit to a sole borrower. To provide individual borrowers with credit facilities that are large in relation to the size of the institution's capital ignores the time-tested principle of diversification of risk. As loans to one borrower increase in relation to an institution's capital, the greater the likelihood that the insolvency of one or a few borrowers may lead to the insolvency of the institution itself. Techniques have long existed that protect depository institutions from concentrations of credit while enabling the funding needs of the borrower to be met. Examples of such techniques include participating or syndicating large loans.

To accommodate large loans above established lending limits, thrifts can develop correspondent relationships with banks or other thrifts for participating or syndicating large loans. Indeed, such relationships have existed for decades in the banking industry and have the added benefit of requiring the borrowers to be subject to independent credit reviews. The participating or syndicating of large loans among depository institutions has long been a vehicle to provide borrowers with sufficient credit to meet their needs even when those needs exceed a particular depository institution's prudential lending limit. In addition to helping an institution provide credit to borrowers above its lending limit, participating and syndicating of large loans works to improve the credit quality of such loans because the participants or syndicate members must perform their own credit analyses and make independent credit decisions as to whether to commit funds to a particular loan. This results in the originators of large loans establishing credit criteria that will meet the requirements of the marketplace for those types of loans.

Regarding the availability of credit to home builders, in our judgment, the reported fall-off in credit to home builders is not attributable to any important degree to the loan limitation provisions of FIRREA. Prudent lending practice dictates that all loans, including development loans, be made with reasonable expectations that they will be repaid as agreed. Recent experience suggests that market conditions have caused many lenders to scrutinize more closely proposed development projects, and place greater emphasis on a project's ability to generate sufficient cash flow to meet its debt service obligation. Moreover, many lenders are continuing to provide loans to credit worthy borrowers having sound track records for projects that make economic sense in light of current and expected market conditions.

Q.3. The RTC has an ambitious plan to try and close or sell 140 thrifts by the end of June 1990. Is this target reasonable and will the Oversight Board monitor these transactions to make sure the RTC avoids making mistakes that could arise during a rush to close a certain number of deals by a given deadline?

A.3. The Strategic Plan laid the foundation for the Oversight Board's role in the case resolution process. The Plan states that the mission of the RTC is to carry out a program, under the general oversight of the Oversight Board, to manage and resolve institutions that come under its jurisdiction and to dispose of any residual assets in a manner that both maximizes return and minimizes loss. In March 1990, the RTC announced a plan to resolve 141 institutions with assets totalling nearly $50 billion between April 1 and June 30, 1990. We endorsed the third quarter plan and approved the funds necessary to carry it out. The RTC was in fact, able to surpass its goal, resolving 155 failed thrifts.

The RTC uses a standard format for the submission of bids, and there is no negotiation of the terms of agreement. The process of case resolution is therefore much less complicated than was true of pre-FIRREA FSLIC deals, which were negotiated individually, and permitted a wide range of types of assistance proposed by the bidders.

Of the 141 institutions targeted for resolution, the RTC identified about 50 which would be resolved either through insured deposit transfers or payouts. This part of the plan was labeled "Operation Clean Sweep", although many people have used the term to describe the entire third quarter program. The Oversight Board had encouraged the RTC over the past several months to place reliance on liquidations and was thus pleased to see the emphasis on this method of resolution in the third quarter.

Q.4 As you know, FIRREA limited the investment powers of federally insured thrifts. During the conference on FIRREA, there was a related discussion of putting a loan-to-value requirement in the statute that would be applicable to both banks and thrifts. As you know, loan-to-value requirements have the effect of requiring developers to put some of their own money into a real estate project before a bank or thrift lends the balance of the funding. As adopted, FIRREA did not contain a statutory requirement, but rather the conference report stated that the regulators were to review their current policies in light of the limits proposed in S. 774 as passed by the Senate on April 19, 1989.

First, please explain the difference, if any, in the economic substance of the risk of loss in owning real estate compared to the risk of loss on a nonrecourse loan that finances 100 percent or more of a real estate project with self-funding interest reserves. If a loan-to-value requirement similar to the one proposed in S. 774 had been in effect in the savings and loan industry, would there have been smaller losses? Would such a loan-to-value requirement have lessened the problems of a bank which engaged in nonrecourse 100 percent financing with interest reserves. What is the status of the Federal Reserve Board's review of its loan-to-value requirement?

A.4. The Federal Reserve has long recognized the risks inherent in direct investments in real estate by commercial banks. The real estate industry is generally considered cyclical and can be adversely influenced by regional economic downturns. Real estate development projects are capital-intensive, are inherently illiquid, and often are subject to title, zoning or environmental issues. These, in turn, can result in delays, cost overruns and increased financial exposure when a financial institution holds a direct investment.

In contrast, the extension of credit secured by real estate usually carries a lower degree of risk than direct equity investments, assuming the proper credit underwriting standards are applied. When properly underwritten, borrowers are required to share the risk with the financial institution by providing equity and personal guarantees. However, when borrowers have little or no equity in the project or have not personally guaranteed the loan, the risk to the lender increases commensurately because there is no equity cushion or recourse in the event of problems. Furthermore, absent equity or personal guarantees, borrowers have less incentive to stay with a project if adverse factors arise. In the most extreme case--a nonrecourse loan with self-funding interest reserves which finances 100 percent of a project--the lender's exposure closely approximates the risk associated with direct ownership. For these reasons the Federal Reserve has normally viewed these loans as imprudent and potentially unsafe and unsound.

In theory, loan-to-value requirements in the thrift industry during the mid-1980s could have reduced industry credit losses, since borrowers' equity would have offset some of the declines in collateral values. Also, if developers had been required to put their own funds at risk to secure construction financing, they would have had a greater incentive to avoid projects with marginal economic viability and would be less likely to abandon projects if problems developed. Thus, the requirements may have curtailed the activities of equity-thin developers that subsequently contributed to over-building and declines in real estate prices which occurred in certain regions, particularly the Southwest.

With respect to whether a formal loan-to-value requirement would lessen the problems of a commercial bank that engages in nonrecourse 100 percent financing with interest reserves, we first note that this type of lending practice would be criticized by System examiners in the examination process, even absent a formal loan-to-value requirement. For example, the commercial bank examination manual used by Federal Reserve examiners indicates that a real estate loan is generally unsound if its liquidation depends on the sale of the underlying real estate or if the amount of the loan is large relative to the fair value of the property. Furthermore, the review of underwriting standards, including requirements for equity in real estate projects, is a fundamental part of our examination process.

While the terms of real estate loans are thus carefully reviewed, the System has not established or historically relied on specific loan-to-value requirements in carrying out these reviews. Rather, the underwriting practices and the quality of the real estate loan portfolio of individual banks have been reviewed on a case-by-case basis. When deficiencies are noted, remedial action is initiated and the subject institution is required to develop and adopt appropriate policies and procedures. Depending upon the severity of the situation, corrective measures may include an enforcement action specifically addressing real estate lending standards.

The Federal Reserve intends to review the question of establishing formal loan-to-value ratios on an interagency basis and in conjunction with the work of the Credit Standards Advisory Committee. This is the body set up under FIRREA that is responsible for reviewing credit standards, lending practices and supervision by federal regulators. The committee is to recommend to the agencies prudential credit standards and lending practices that are consistent for all insured depository institutions.

QUESTIONS FOR THE RESOLUTION TRUST CORPORATION OVERSIGHT BOARD
FROM TERRY SANFORD
MAY 23, 1990 HEARING

Q.1 One issue related to RTC that could become "lost in the shuffle" is the disposition of properties that have exceptional natural or environmental values. At a previous hearing, I asked several questions relating to the process by which RTC would identify such properties and what special processes would be established to help ensure that these areas are properly treated. It is my hope that this matter will not be "lost in the shuffle".

a. It is my understanding that the U.S. Fish and Wildlife Service has offered to help RTC identify properties with environmental significance and to draft proposed conservation easements or other protective measures which could be used to preserve natural values on such lands. I understand that the Service has drafted a proposed Memorandum of Understanding to formalize this mechanism. What is the status of the proposed MOU? If there are some problems with the details of the proposed MOU, can we expect RTC to enter into some sort of agreement with the service in the near future?

b. I also understand that the Council on Environmental Quality has expressed some interest in these questions. Does RTC have any type of formal agreement with CEQ regarding environmentally sensitive properties, and can we expect to see such an agreement in the near future?

c. At a previous hearing, I asked whether RTC viewed themselves as being subject to environmental laws specifically affecting government agencies, such as the National Environmental Policy Act and the Freedom of Information Act. At that time, RTC's attorneys had not made a decision on the matter. Has a decision been made? If the decision is to be "yes", who will have responsibility for drafting NEPA or other environmentally-related documents? If "no", will RTC attempt to follow the spirit of such laws by providing environmental information? On what grounds might one find that RTC is NOT subject to such laws?

d. As you may know, there is a great deal of interest in North Carolina in a particular property on the Outer Banks which is known as Nags Head Woods. I understand this is an area containing rare wetlands habitat and maritime forest, and has been designated as a National Natural Landmark. I further understand that a conservation group has submitted a bid for the property which is below the last appraised value. However, the appraised value for the property apparently did not take into account the fact that the majority of the property is wetlands, which would considerably lower the potential for development.

What would be the process by which RTC could accept a "below-market" bid for a property with special environmental characteristics? Would a second appraisal have to be done reflecting, as in the above case, factors such as wetlands which may not have been included in the initial appraisal, and would that second appraisal have to show that a bid was in fact close to market value,, or is there some flexibility in such cases?

e. What progress has been made since the last hearing in terms of inventorying environmental sensitive properties; developing criteria by which such properties are to be selected; and conveying environmental information to the public?

A.1 (a) The RTC has worked closely with the Fish and Wildlife Service in the drafting of the MOU. We understand that the RTC is satisfied with the document as it stands and is prepared to execute it. The MOU is now under review by the Department of the Interior.

(b) The Council on Environmental Quality arranged a meeting in the spring which was attended by representatives from various agencies, including the RTC and the Oversight Board. Issues involving the environmental obligations of government agencies, including the RTC, were discussed at this meeting. The Council on Environmental Quality expressed their support for cooperation between the RTC and the Fish and Wildlife Service. Since then, RTC staff has worked directly with the staff at the Service to produce the MOU.

(c) The applicability of federal environmental laws to the RTC is a matter currently under review by RTC attorneys, as well as by the Council on Environmental Quality and the Justice Department. The determination turns on whether the RTC is an "agency" within the meaning of that term as defined in various statutes. If it is determined that the environmental statutes do not impose legal obligations on RTC, RTC must nevertheless follow responsible policies with respect to environmental issues facing it. The RTC has engaged an environmental consulting firm which is helping to develop such policies.

The RTC is subject to the Freedom of Information Act.

(d) According to the RTC, the appraisal on Nags Head Woods did take into account the fact that part of the property consisted of wetlands. An environmental group submitted a bid for the property at approximately half of the appraised value. FIRREA gives RTC no authority to dispose of properties with environmental significance at sales prices below market value. (e) As of January 1, 1990, the RTC's real estate inventory has been available to the public. It identifies properties with natural, cultural, recreational, or scientific values of special significance. Since then, the RTC has updated the inventory, as it is required to do so semiannually under FIRREA. As noted above, the RTC has reached agreement with the Fish and Wildlife Service on an MOU, under which the Service would help the RTC to identify and review properties of environmental significance and make recommendations regarding their disposition.

Q.2 Secretary Brady's testimony notes that thrifts do not have an attractive a charter relative to banks as they once had.

1. What do you think makes their charter less attractive?

2. Is the attractiveness of the thrift charter something we should be concerned about? Should we change the thrift charter in any way, given that an inability to attract investors to thrifts raises the cost of the bailout, or should be leave things as they are?

A.2 Stricter regulatory requirements, such as the new capital standards, may have made thrift ownership less attractive in the business planning of some investors. These requirements are part of the reforms designed to improve the safety and soundness of thrifts. We do not feel that they should be abandoned in order to attract thrift investors who might find them prohibitively onerous. Although greater interest in thrift ownership might lower the resolution costs somewhat, we feel the cost savings should not be sought at the expense of safety and soundness in the industry.

QUESTIONS FOR THE HONORABLE NICHOLAS BRADY
BY SENATOR DONALD W. RIEGLE, JR.

Q.1 In you testimony, you provide estimates of the RTC's losses of $89 billion, $97 billion, $114 billion, $99 billion, $118 billion, and $132 billion. Please explain the assumptions underlying the numbers you selected for your estimates of the small, medium and large losses on asset sales and the other factors in your calculations as well as the numerical calculations for which you derived these estimates?

A.1 These estimates represent an attempt to predict the difference between the amount of money that the government will pay to protect depositors and the amount of cash that will be generated from selling the assets of the failed thrifts. The range of the estimates reflects the enormous uncertainty surrounding both the former number (how many thrifts with how much in deposits will fail?) and the latter number (the amount of the insurance obligation that can be funded through sales of assets, which depends largely on the value of those assets).

With respect to the first fundamental underlying assumption, the estimates assumed that the RTC will have to resolve between about 700 to just over 1,000 thrifts. The lower number is based on the number of thrifts the RTC has already resolved and those currently in conservatorship, plus those thrifts that the OTS considers likely to fail and be transferred to the RTC (the so-called OTS Group IV thrifts). The higher number assumes that, in addition to all of these thrifts, all of the "Group III" thrifts considered by the OTS to be troubled due to poor earnings and low capital require RTC funds.

With respect to the second fundamental assumption -- the value of the assets of these groups of failed (or potential future failed) thrifts -- the estimates are based on a range of estimated loss rates on thrift assets. Of course, like the stock market and markets in general, the market value of the failed thrifts' assets -- whether government bonds, mortgage-backed securities, mortgage loans, or foreclosed real estate properties -- fluctuates with general market conditions. In recognition of this uncertainty, the range of the estimates in turn rests on a range of "haircuts", or mark-to-market loss percentages. For the approximately 700 thrifts included in the lower estimates, the average haircuts as a percent of the thrifts' aggregated assets were 13.7, 16.3, and 22.5 percent, depending on the loss scenario (i.e., low, medium, or high). For the approximately 1,000 thrifts included in the higher estimates, these average haircuts were 12.4, 15.5, and 20.8 percent. In both cases, the haircuts for the medium scenarios were based on actual experience of the FDIC in bank failure cases.

Q.2 What are your current estimates of the number of thrifts (and estimated dollars of assets and deposits) the RTC will resolve in each calendar quarter for the next year and a half? What are your estimates of working capital needs for that same period? Please provide the calculations and assumptions that explain how you made these determinations.

A.2 The estimates are not based on an assumption about the number of thrifts to be resolved each quarter, but on the total assets of thrifts to be resolved. The pace of resolution assumed for most of the estimates was $40 billion of assets per quarter, consistent with expectations about the sustainable pace of resolutions going forward. This pace was assumed to continue at the same level until all troubled thrifts are resolved, so the amount of assets for the next year and a half was assumed, for purposes of the estimates, to be $240 billion over this period ($40 billion times six quarters).

We have estimated that the RTC's working capital needs for fiscal year 1991 could be $40 billion. Because the working capital needs of the RTC will depend upon, among other things, the amount of assets the RTC can pass to acquirers, the market value of the assets and the pace at which the remaining receivership assets are sold, any estimates will be subject to a great deal of uncertainty. To ensure that these numbers are as realistic as possible, the estimates are based on actual RTC experience and expectations. Although our estimates assume a relatively even distribution, the RTC's actual quarterly needs will depend upon the order in which it conducts its resolution activities.

Q.3 The RTC appears to be having a very difficult time doing "whole bank" deals and selling the assets of thrifts in bulk. This seems to have caused the RTC to retain a higher percentage of assets from its case resolutions than the Administration originally estimated. Now the RTC is announcing it will discount assets up to 20% and 30% when they are sold individually after the thrift has been "resolved." Has the RTC considered providing those discounts from appraised value to purchasers at the time of acquisition? Is the RTC considering any method of disposing of its assets in bulk?

A.3 The RTC uses appraisals to provide an objective opinion of the market value of real property assets. RTC asset staff monitors the RTC's marketing of property. In May 1990 the RTC revised its policy to permit the asset manager to recommend revising the established market value of a property if it has been aggressively marketed and either (a) no offers were received; or (b) all bona fide offers received were significantly lower than the appraised value. Reductions of up to 20 percent from appraised value would be permitted. The first revision will be allowed after the asset has been actively market for at least six months (four months for single family homes). Subsequent revision would require at least three months of additional marketing. The purpose of this policy is to allow the RTC to find the market value of the assets it is trying to sell -- not to provide for discounts.

Because this policy is applicable to real estate owned in conservatorships as well as receiverships, market value reductions of real property assets would be possible before the institution is resolved. In addition, we understand that the RTC is looking at other ways to better capture the market value of assets at time of resolution, but has not presented any conclusions or recommendations to the Oversight Board at this time.

In May 1990, the RTC also issued a policy with regard to the use of auction sales. In order to stimulate active bidding associated with the auction process, for properties appraised over $100,000, the RTC may set reserve prices at less than the appraised value. The lowest reserve price that can be set is 70 percent of current appraised value, adjusted for any savings of sales expenses or other costs resulting from an expedited sale. There will not be automatic discounts. Each property will be individually analyzed to determine its reserve price and that price will have to be rigorously documented prior to its inclusion in the sale.

In addition, the Oversight Board has approved a plan that will allow the Resolution Trust Corporation to provide, on a trial basis, financing for up to $2 billion of bulk sales transactions of RTC assets. To facilitate sales of assets, the RTC will identify blocks of assets, including groups of commercial loans (both performing and nonperforming), commercial properties, multi-family residential properties, and multi-family residential loans (both performing and nonperforming). These groups of assets will then be sold in bulk packages.

Q.4 It is my understanding that the FDIC Division of Liquidation (DOL) is responsible for the sales and collections from assets in the FSLIC Resolution Fund and from failed banks and it does not coordinate its marketing efforts with the RTC. Currently, DOL is responsible for about $25 billion in such assets. Would the taxpayers be well served by a coordination of marketing efforts designed to keep the total cost of the bailout at a minimum?

A.4 The law requires the RTC to dispose of assets in a manner that maximizes return and minimizes loss; minimizes the impact on local real estate and financial markets; and maximizes the preservation of the availability and affordability of residential property for low- and moderate-income individuals. Yes, the taxpayers would be well served by a coordination of marketing efforts between the FDIC and RTC, and we believe a great deal of coordination does occur. The FDIC's Division of Liquidation, in its disposition of assets, follows policies similar to those developed by the RTC. The two agencies share and jointly disseminate information. In addition, many RTC employees working in the asset disposition division were formerly employed in a similar capacity at the FDIC.

Therefore, there is already in place an overlap of policy and personnel between the RTC and FDIC, as well as a sharing of information between the two agencies. The Oversight Board will continue to monitor this issue.

Q.5 In your testimony, you indicate that the cost of resolving the thrift problem will range from a low of $89 billion to a high of $132 billion. These estimates include $73 billion that you maintain was made available by FIRREA. You gave these estimates in terms of "present value" -- the amount of money that would be required to be spent if the problem were to be completely resolved today. These estimates are very helpful, however, it is likely to take a number of years to resolve the thrift problem.

a. To this end, it would help clarify the record if you could provide estimates of the cost of resolving the problem on a cash outlay basis for each year until 1999. I would appreciate it if you would also include outlay estimates for the FSLIC Resolution Fund over the same period.

b. At the May 24, 1990, meeting of the budget summit negotiators, OMB Director Darman presented a chart that gave high and low estimates of RTC outlays for each year through 1995. Are Director Darman's outlay estimates derived directly from your present value estimates? specifically, do your low estimates comport with his low estimates and your high estimates with his high estimates?

c. In your testimony you indicate that FIRREA authorized the Treasury to provide up to $32 billion for the SAIF to meet its obligations in the 1990s. This stands in some contrast to earlier estimates made to the Committee. For instance, on March 2, 1989, Director Darman testified that the SAIF would have total cash outflows of $24 billion from 1991 through 1999. That is our exact understanding of the resources available to the SAIF? How much of these funds will come from the Treasury and how much from premiums? What will be the buildup in the SAIF fund over the decade of the 1990s?

d. You say in your testimony that the cap on obligations of the RTC could cause the RTC to shut down its operations even before it runs out of funds to spend on net losses. If this is the case are you considering any modifications to this cap?

A.5 a. We have attached tables containing estimates of the disbursements and collections associated with both the RTC and the FSLIC Resolution Fund (FRF) through fiscal year 1995. These tables were used by OMB for the Midsession

Revision of the President's Budget. The RTC table is based upon information supplied by the Oversight Board; although this table does not contain estimates through 1999, most of the RTC's activities, with the exception of the sale of some of the worst assets, are assumed to be completed by 1995.

As you know, the RTC has only recently completed a review of many of the resolutions for which FRF is responsible. Thus, the FRF table does not reflect any new estimates based upon this review.

b. Oversight Board, Treasury, and the OMB staff have worked closely together in developing estimates of the cost of resolving the savings and loan crisis. Therefore, there is a high degree of conformity between the present value estimates given by the Oversight Board and the cash-based budget estimates generate by OMB.

c. As we said in our testimony, FIRREA authorizes Treasury to provide as much as $32 billion for SAIF between 1991 and 1999, although it was not anticipated that SAIF would require this full amount. As Director Darman testified to the Senate Banking Committee on March 2, 1989, the estimates for SAIF's cash outflows when the Administration presented its original proposal to both Banking Committees in February, 1989 was $24 billion from 1991 through 1999. Cash inflows, about half of which were accounted for by Treasury appropriations, were estimated to be $32.8 billion during this same period.

The Administration's estimates have been revised since that time. We have attached a table containing estimated disbursements and collections for SAIF. This table was used by OMB in preparing the Midsession Review of the President's budget.

d. The RTC will always find itself constrained by the obligation limitation (or note cap) before it has used up authorized loss funds, at least as it presently interpreted. We do not believe that anyone intended for the resolution process to shut down before all loss funds were expended and would therefore support a modification to the cap to prevent unnecessary interruptions in RTC activity. We will of course also need a change in the cap to bring it into conformance with any new loss funds which the Congress provides to the RTC.

MIDSESSION REVIEW FY 1991
($ in millions)

FSLIC Resolution Fund

	FY 90	FY 91	FY 92	FY 93	FY 94	FY 95	90-95
Interest on Notes Payable	1,566	1,863	1,836	1,807	1,663	1,555	10,290
Assistance Payments	5,688	5,193	4,249	4,081	2,721	2,016	23,948
Repayment of Pre-1987 Notes	4	56	0	85	35	76	256
Asset proceeds paid to REFCORP							
Other Disbursements	262	288	288	288	288	288	1,702
TOTAL DISBURSEMENTS	7,520	7,400	6,373	6,261	4,707	3,935	36,196
FICO Proceeds							
Net Insurance Premiums	(101)	(1,192)	0				(1,293)
Asset Proceeds	(1,370)	(1,834)	(1,763)	(1,323)	(660)	0	(6,950)
Interest Income	(43)	(29)	(29)	(29)	(29)	(29)	(188)
Other income	(192)	(125)	(125)	(125)	(125)	(125)	(817)
TOTAL COLLECTIONS	(1,706)	(3,180)	(1,917)	(1,477)	(814)	(154)	(9,248)
NET OUTLAYS	5,814	4,220	4,456	4,784	3,893	3,781	26,948
Repayment of Post-86 Notes	626	273	198	751	1,811	77	3,736
Appropriation	6,440	4,493	4,654	5,535	5,704	3,858	30,684

July 13, 1990

RESOLUTION TRUST CORPORATION
ADJUSTED BASELINE
RTC: **Medium Loss Estimates**
($ in millions)

SCENARIO: $40 B in assets; Medium Haircut; 1027 thrifts

	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94	FY 95	FY 89-95
DISBURSEMENTS:								
1. Purchase of assets	942	40,602	68,541	66,262	40,770			217,117
2. Advances	8,550	8,567						17,117
3. Payment for net losses	810	33,929	38,530	24,563	10,805			108,637
4. Administrative expenses	6	1,021	5,244	6,935	6,859	3,221	887	24,173
5. FFB interest payments		564	3,805	6,522	5,021	2,795	1,010	19,717
TOTAL DISBURSEMENTS	10,308	84,683	116,120	103,282	63,455	6,016	1,897	384,761
COLLECTIONS:								
6. REFCORP/FHLB Receipts	(1,200)	(18,019)	(11,961)					(31,208)
7. Asset receipts	(0)	(2,907)	(35,184)	(59,234)	(67,529)	(47,891)	(21,913)	(234,438)
8. Repayments of advances	0	(6,625)	(5,391)	(2,746)	(1,373)			(16,135)
TOTAL COLLECTIONS	(1,200)	(27,551)	(52,536)	(61,980)	(68,902)	(47,891)	(21,913)	(281,778)
RTC NET OUTLAYS	9,108	57,132	63,584	41,302	(5,447)	(41,875)	(20,016)	102,988
ADDITIONAL FUNDS REQUIRED			28,588	31,486	17,684	3,221	887	81,858